WASMER, SCHROEDER & COMPANY

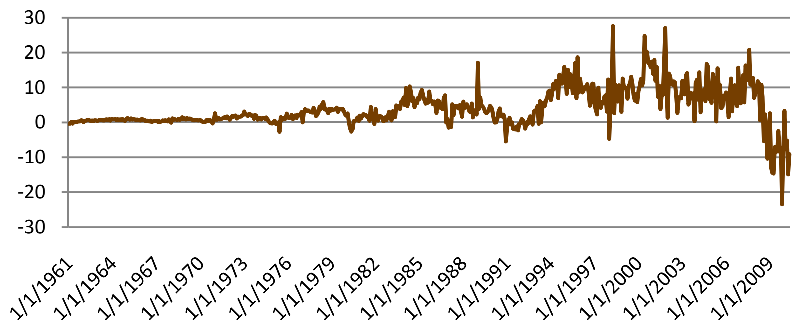
INVESTMENT ADVISORS

BOND MARKET WEEKLY | WEEK OF JULY 12, 2010

MARKET OVERVIEW

Net Change in US Consumer Credit (Billion USD)

monthly, 1/1/1961 - 5/31/2010; Source: Bloomberg



- Last week's improved market action in Europe, a bounce in US equities, and positioning for next week's new supply of 10 and 30-year bonds led to a reversal of some of the recent US Treasury market gains. The benchmark 10-year yield rose 7 bps to close Friday at 3.05%, retracing nearly half of the prior week's gains. Weakness was most pronounced in long maturities and led to a steepening of the yield curve by 7 bps (+242) from 2 to 10-years and 10 bps (+341) from 2 to 30-years.
- A solid 10-year TIPS auction highlighted the week for the sector. Breakeven inflation measures over the longer term 5-year, 5-year forward period spiked 11 bps to 2.37%. The immediate 5-year horizon saw breakeven inflation grind 2 bps lower to 1.51%, however, marking the lowest close since October of 2009.
- After a hugely disappointing employment report two weeks ago, last week's economic data calendar was largely uneventful. ISM non-manufacturing slipped to 53.8, and was largely consistent with the theme of rolling over measures of late. Jobless claims (weekly continuing 4413k vs. 4600k) were improved but economists lack conviction on how seasonal auto factory retooling is affecting the measures.
- June ICSC Chain Store Sales were also a mixed bag and showed a 3% gain year-over-year, which was lower than expected. Retail sales do not appear to be helping on the borrowing front. Deleveraging remained in full force in May with a $9.1 billion contraction in consumer credit (see chart above). Added to revisions from prior month estimates, the contraction was some $22 billion greater than expected.
- A busy calendar this week should help sort out the dynamic market psyche as retail sales, PPI and CPI price measures, Philly and Empire manufacturing surveys, and industrial production headline a data dependant week of trading.

TAX EXEMPT MARKETS

- Municipals rallied on an absolute basis last week and tightened relatively this week, as US Treasuries gave up some of their flight to quality gains. High quality municipals saw 10 and 30-year yields fall eight and nine basis points, respectively, to 2.94% and 4.46%.
- Cash continues to flow into tax exempt mutual funds, which provides fundamental support to the supply/demand profile of municipals in the short term. In-flows to tax-exempt mutual funds as reported by The Investment Company Institute continue to trend up as $558 million flowed in the week of June 30th versus $438 million in the week of June 23rd.
- Visible supply trended upwards last week from the prior week's anemic $5.5 billion, which was impacted by the July 4th holiday. At weeks end the Bond Buyer 30-day Visible Supply Index sat at $7.3 billion.
- The next few days we expect to see new deals from the Arizona Water Infrastructure Financing Authority, State of Illinois (BABS), and the Los Angeles Community College System.

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TAX EXEMPT MARKETS (CONT.)

- With the jobs bill languishing in the Senate, state, city, and county groups increased pressure to extend the popular Build America Bonds program. The program was crafted as a component of the stimulus package last year and is credited with reducing the borrowing costs for public works projects. In a letter addressed to Sen. Bacchus (D-MT), the group said not extending the program would have "immediate, unintended, and negative consequences".
- Last week saw a flurry of activity as we began putting July 1st payments to work and continued to upgrade credit quality and liquidity within portfolios. Given the current flatness of the municipal credit curve and the relative steepness of the yield curve, we have tactically looked to upgrade credit quality and enhance the risk/reward profile of portfolios.

TAXABLE MARKETS

- Corporate spreads finished the week 5 bps tighter. The Barclays U.S. Corporate Investment Grade Index closed at +188 OAS (option-adjusted-spread). Market sentiment improved as more details came out about the European bank stress tests than the market had been expecting and on the anticipation of a strong Q2 earnings season.
- Alcoa kicks off 2nd quarter earnings announcements today. For the broad market, many expect to see positive results. According to a Bloomberg survey, analysts expect 2Q10 profits for S&P 500 companies to rise 34%. When asked the same question in last quarter's survey, the same group estimated a 27% rise in the 1Q10 profits.
- Corporate new issuance regained its pace after a very quiet pre-holiday week. $14.8 billion of investment-grade corporates were priced according to Bloomberg, with the headline-grabber being Time Warner Inc. (Baa2/BBB). They priced $3 billion of equally portioned 5-year, 10 1/2 –year, and 30-year debt at spreads of +140, +175, and +215, respectively. Demand was well oversubscribed.
- MBS continued to rally. With the global economic anxieties in the 2nd quarter of 2010, the MBS market provided a safe haven for investors. Using the Barclays U.S. MBS Index as a broad measure, the market rallied during the quarter from a 4.01% YTW on 3/31/10 to 3.10% on 6/30/10 and the OAS went from +20 to +11. This rally has been atypical as the Fed is now the largest holder of MBS and because of lower than historical refinancing due to tighter lending criteria and fewer eligible borrowers.
- The MBA Weekly Survey released data ending July 2nd showing the purchasing index dropping 2.0% and the refinance index rising 9.2%. Freddie Mac's national survey of 30-year mortgage averaged 4.57%, down 1 bps from the previous week.

About the Firm: Wasmer, Schroeder & Company, Inc. (WSC) is an independent and employee-owned owned Florida S-Corp. WSC was incorporated in 1987 and registered as an investment advisor in 1988 with the U.S. Securities and Exchange Commission. The Firm's corporate headquarters are in Naples, Florida, where the tax exempt Portfolio Management team, Client Services, Operations, IT, Accounting, Compliance, Marketing and Administration reside; our taxable Portfolio Management team is located in Cleveland, Ohio; and Client Relationship offices in Philadelphia, Pennsylvania and Lake Oswego, Oregon. Specializing in fixed income separate account portfolio management for high net worth individuals, wealth management groups and institutions, including foundations, endowments and retirement plans, WSC has over $3.46 billion in assets under management, as of 3/31/10. The Firm works with clients and their advisors to construct taxable and tax exempt fixed income portfolios tailored to their preferences and constraints and typically include a mix of cash and fixed income securities.