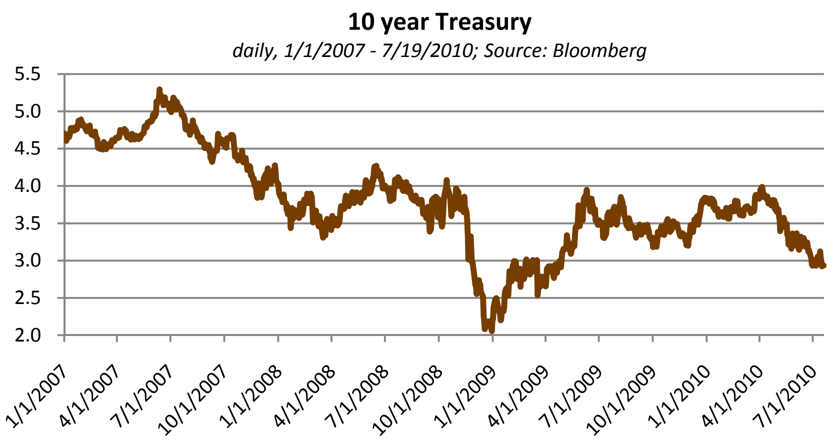
WASMER, SCHROEDER & COMPANY

INVESTMENT ADVISORS

BOND MARKET WEEKLY | WEEK OF JULY 19, 2010

MARKET OVERVIEW



- US Treasuries posted solid gains last week on the heels of successful auctions, bond friendly economic data, a downbeat Fed report and disappointing corporate earnings. Buyers shifted their focus back towards safety and income as the benchmark 10-year Treasury note closed 11 bps lower in yield last week to 2.94%.
- With yields already compressed in short maturities, bearish economic sentiment has led to a continued bull flattening of the yield curve. Spreads from 2- to 10-years fell 8 bps to +234, while the 2- to 30-year measure slipped 6 bps to +335. Both measures are well below the February peaks; however they still represent a historically steep slope in the yield curve and a potential performance catalyst for fixed income portfolios.
- TIPS yields declined last week but could not keep pace with the move in nominal Treasuries. The result was 9 bps less in breakeven inflation expectations (1.42%) over the current 5-year horizon and 8 bps (2.28%) below last week's close for the 5-year, 5-year forward period. The former continues to drop precipitously since April, when the measure seemed firmly entrenched in the 2.20% range.
- Last week delivered a significant calendar of economic data. We learned through the NFIB's Small Business survey that this segment of the economy remains depressed after the survey dipped back to 89 in June. Retail sales fell outright in June (-.5%) while sales ex. autos and gas managed just a .1% gain. Meanwhile, Jobless Claims were mixed and largely ignored by the market (429k initial, 4681k continuing) as the auto industry's factory retooling period will tend to skew seasonal adjustments for the next few weeks.
- Catalysts for lower bond yields came on strong late in the week as very disappointing Philly Fed and Empire Manufacturing Surveys both dipped to 2010 lows with similar readings of 5.1. A disappointing U. of Michigan Confidence number on Friday delivered a final boost to bond prices for the week. This continued theme of softening growth indicators, combined with still muted CPI in June (-.1% headline and .2% core), provides added momentum for lower bond yields heading into the new week.

TAX EXEMPT MARKETS

- Municipals continued their rally on the back of a strong Treasury market, low supply, and large amounts of cash from July reinvestment maturities and income. Yields on 10- and 30-year bonds fell 6 and 3 basis points to 2.88% and 4.42%, respectively.
- Mutual fund inflows continued their brisk pace with the Investment Company Institute reporting $979 million in inflows for the week ending July 7th, one of the highest weeks of the year.
- Supply remains constrained with the Bond Buyer 30-day Visible Supply Index ending the week at $7.96 billion; much of this projected supply will likely come in the form of taxable BABs. A sell off in the tax exempt market seems unlikely in the short run absent meaningful weakness in US Treasuries.
- On the new issue front, there are two airport deals coming this week for the Miami Airport ($523 million) and the DC Airport ($387 million). We are holders of both issuers and will likely be involved in one or both deals this week.

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TAX EXEMPT MARKETS (CONT.)

- In ratings news, the state of Arizona was downgraded to Aa3 by Moody's due to continued budget stress. The action by Moody's was widely anticipated and market reaction was minimal as a result. While economic reports remain mostly negative, a few bright spots have emerged with New York local and county sales tax collections up 10.6% for the first half of the year, and with New York City seeing a 20.6% gain.
- We are focusing on the 7- to 10-year portion of the curve as the best relative value while continuing to upgrade credit quality in portfolios due to tight spreads and low absolute yields. Last week we purchased new issues for the Kentucky State Housing Authority (rated Aaa) and the Los Angeles Community College District (rated Aa1).

TAXABLE MARKETS

- Corporate spreads finished the week 6 bps tighter with the Barclays U.S. Corporate Investment Grade Index closing at +182 OAS (option-adjusted spread). Demand in the new issue market continues to be very strong and new deals are often many times oversubscribed. Financials continued their relative outperformance this month as the passage of FINREG legislation brought some much needed clarity with regards to expectations in the banking sector.
- There was significant new issuance activity this week across the corporate bond sector as $27.5 billion was priced according to Bloomberg, making this the busiest week since March. Notable issuers this included Target (10-yr), Oracle (10- and 30-yrs) and JP Morgan (5- and 10-yrs).
- Last week brought with it a slew of earnings releases within the banking sector with Citigroup, Banc of America and JP Morgan all reporting second quarter numbers. Overall, results were mixed. While profitability fell hard in capital markets related activities, loan loss provisions were slashed, adding to earnings.
- MBS continued to rally as investors view the market as a safe haven. Using the Barclays U.S. MBS Index as a broad measure, the MBS market has rallied from a 4.01% YTW on 3/31/10 to 2.93% on 7/16/10, while the OAS has plummeted from +20 to 0. This could be related to the market's perception that the Fed may step in and pursue additional quantitative easing - with mortgages representing their most likely purchases.
- The MBA Weekly Survey released this week (for the week ended July 2nd) showed the purchase index falling 2.0% and the refi index rising 9.2%. Freddie Mac's national survey of 30-year mortgage rates averaged 4.57% for 30-year conventional mortgages, down 1 bps from the previous week.
- Agency supply continues to fall. Spreads drifted tighter and demand remains strong. Lack of loan production has been the primary driver pushing banks towards the agency market. With the recent rally in Treasuries, investors are demanding additional call protection.

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 $3.57 billion in assets under management, as of 6/30/10. 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.