

FIXED INCOME MARKET SUMMARY

FEBRUARY 2012

Economy

Economic reports during the month generally improved but are being regarded with some caution. Downside growth risks include potentially greater sensitivity of the U.S. financial system to European banking/fiscal difficulties. In contrast, the upside includes potential household pent-up demand for durable goods and single-family dwellings, in addition to further stimulus measures from the Fed or U.S. government.

The month of February ended with Fed Chairman Bernanke's semi-annual Monetary Policy Report, aka Humphrey-Hawkins testimony. The Chairman gave no clear signal that the committee is considering further monetary easing in the near future. On his description of the economy, the Chairman was relatively cautious, saying that growth had been "uneven and modest", but he did note positive developments in the labor market. He ended his remarks saying that there had been "somewhat different signals" recently about growth, and that the committee will need to evaluate incoming information about the pace of the recovery.

- **GDP:** The second report on Q4 GDP came in better at 3.0%, versus the first estimate of 2.8%. All major categories improved mildly to increase the headline.
- **Employment:** Initial jobless claims provide evidence the labor market is improving. Claims ended the month at 351k, the lowest level in four years.
- **Confidence:** Confidence measures continue to improve but will be subject to rising gas prices. The Conference Board's index increased to the highest level in a year while the Bloomberg consumer comfort index rose to an almost four-year high.
- **Gasoline Prices:** The average price for a gallon of gasoline in the country increased from \$3.45 to \$3.74 during the month, after touching a low of \$3.21 in late December.
- **Manufacturing:** Although regional Fed manufacturing surveys moved higher during the month, the ISM manufacturing survey fell unexpectedly, led by drops in new orders and supplier deliveries.
- **Vehicle Sales:** Total vehicle sales came in at an annualized rate of 15.04 million, versus expectations of 14.00 million. It has been four years since the market has seen such levels.

The Bond Markets

The Barclays Capital Universal Index rose 0.23% in February, down from 1.08% in January and 1.17% in December. Like last month, risk assets had the best performance, led by a 4.00% return in emerging markets and 2.37% in high yield. Treasury securities had the only negative performance, losing 0.71% among major asset classes. Low-quality assets provided the best returns

with Baa-rated assets returning 1.23% while assets rated Aaa lost 0.31%. Similarly, assets maturing in 10+ years lost 0.38% while shorter maturity securities gained.

During the month, Treasury yields moved higher across the curve and the yield curve steepened by 9 basis points (bps). The yield on the 2-year security rose by 8 bps, and the yield on the 10 year security rose by 17 bps. Inside two years, the 3 month T-Bill continued moving higher, rising almost 3 bps during the month. The Fed's "Operation Twist" program continues to buy bonds on the long end while selling shorter-maturity bonds. The program has helped flatten the yield curve which closed the month at 168 bps, down from 209 bps in late October.

	Total Return February	Total Return Calendar Year 2012
Barclays Capital Universal	0.23%	1.32%
U.S. Treasury	-0.71%	-0.29%
Government Related	0.07%	1.11%
Corporate	0.84%	3.07%
Securitized	0.15%	0.67%
U.S. Corporate High Yield	2.37%	5.48%

