FIXED INCOME STRATEGY HIGHLIGHTS … JULY, 2011

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THE U. S. FIXED INCOME MARKETS

Brief Overview:

We believe that any rise in Treasury yields created by a potential downgrade of the U.S. sovereign rating to the AA level would be relatively moderate, on the order of 25bps, with shorter maturity bonds widening less but longer maturity bonds widening more. We continue to see value in investment grade corporate bonds, as we believe they will likely outperform government-related sectors of the bond market under the base case scenario where the market continues to embrace risky assets. Should the U.S. government's debt rating get downgraded, certain categories of municipal bonds whose ratings are linked to the rating of the U.S. will also be downgraded. Downgrade of the U.S. sovereign rating to the AA level would be relatively moderate, on the order of 25bps.

Given the near term uncertainties and the steepness of the yield curve, we favor a neutral duration allocation, and favor maturities in the 4 to 7-year portion of the curve. With the Fed likely to keep monetary policy extremely easy (0% Fed Funds) for the foreseeable future, the absolute level of short-term bond yields should stay extremely low, rendering money market assets and short maturity bonds unattractive, in our opinion.

Government-Related Debt/MBS

- Callable U.S. Agencies offer incremental income, and could outperform non-callable bonds should Treasury yields remain range bound to slightly higher over the next 12 months. We believe agency mortgage-backed securities offer attractive positive carry (cost) versus Treasury securities.

High-Grade Corporates and Preferreds

- Given the steepness of the yield curve, bonds that mature in 4 to 7 years should outperform both shorter and longer-dated bonds, despite the likely upward trajectory of Treasury rates. We favor bonds in the BBB-rating category. European financial preferreds will likely remain sensitive to sovereign concerns. To help reduce possible price volatility, focus on securities likely to be called such as U.S. bank trust preferreds (be mindful of extension risk and regulatory call risk) and high coupon DRDs.