ALTMAN INVESTMENT MANAGEMENT

FIXED INCOME STRATEGY HIGHLIGHTS

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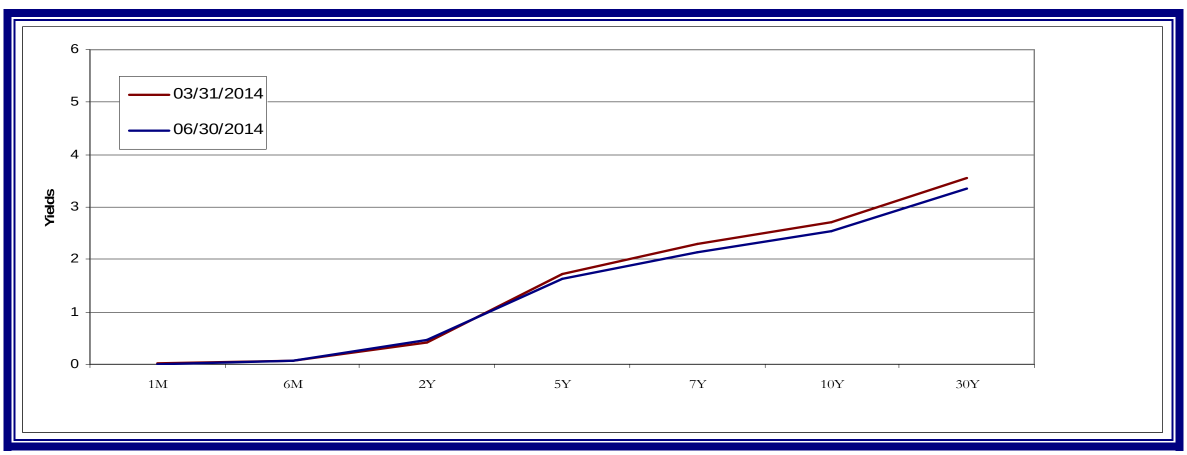
THE U.S. FIXED INCOME MARKETS

Brief Overview:

Although the bond market's strong first-quarter performance was surprising, the continuation of the rally through the second quarter proved even more compelling. Coming into 2014, consensus expectations was that bond yields were too low and could only go in one direction – up – at a time in which the U.S. Federal Reserve was tapering its quantitative easing policy.

As is usually the case, the consensus was way off the mark. Bond prices in fact rallied through the first six months of the year (as yields fell) compounding investor's negative expectations that continue to hang over the market even now. The yield on the 10-year Treasury note closed the quarter at 2.52%, down from 2.72% on March 31 and 3.03% at the end of 2013.

Active Government Yield Curves



Source: Altman Investment Management Research and Bloomberg

A wide range of factors came together to fuel the bond market's improved second quarter showing. Economic data continued to point to an environment of slow, but steady growth – positive enough to support the performance of corporate and high yield bonds, but not so fast as to raise concerns that the Fed will begin raising short-term interest rates sooner than the middle of next year.

Along that same line, inflation was well behaved: positive enough to dampen concerns about potential deflation, but still low enough that the Fed can maintain its gradual pace of lightening its accommodation policy. This steady, lukewarm environment was ideal for the bond market by providing investors with high visibility regarding Fed policy expectations.

Supply-and-demand factors also played a part in the rally. The declining budget deficit led to a reduced supply of new Treasury securities, meaning that the Fed was able to reduce its bond-purchasing program without disrupting the balance of supply and demand.

Instability in the geopolitical realm - namely, the Russia-Ukraine conflict and civil war in the Middle East further boosted Treasuries by encouraging a "risk on trade."

Second Quarter Performance Numbers

The second quarter returns of the various asset classes within the bond market are as follows. Where index returns are unavailable, the relevant ETFs are used in their place.

- **Investment-grade U.S. bonds** (Bank of America Aggregate Bond Index): 2.04%
- **Short-term U.S. Treasuries** (Bank of America 1-3 Year US Government Index): .27% %
- **Intermediate-term U.S. Treasuries** (Bank of America US Government Intermediate Index): .99%
- **Long-term U.S. Treasuries** (Bank of America US Government Long Index): 4.71%
- **TIPS** (Bank of America US TIPS Index) 3.81%
- **Mortgage-backed securities** (Bank of America Mortgage Index): 2.33%
- **Municipal bonds** (Bank of America Municipal Bond Index): 2.59%
- **Corporate bonds** (Bank of America Corporate Investment Grade Index):.2.66%
- **High yield bonds** (Credit Suisse High Yield Index): 2.32%

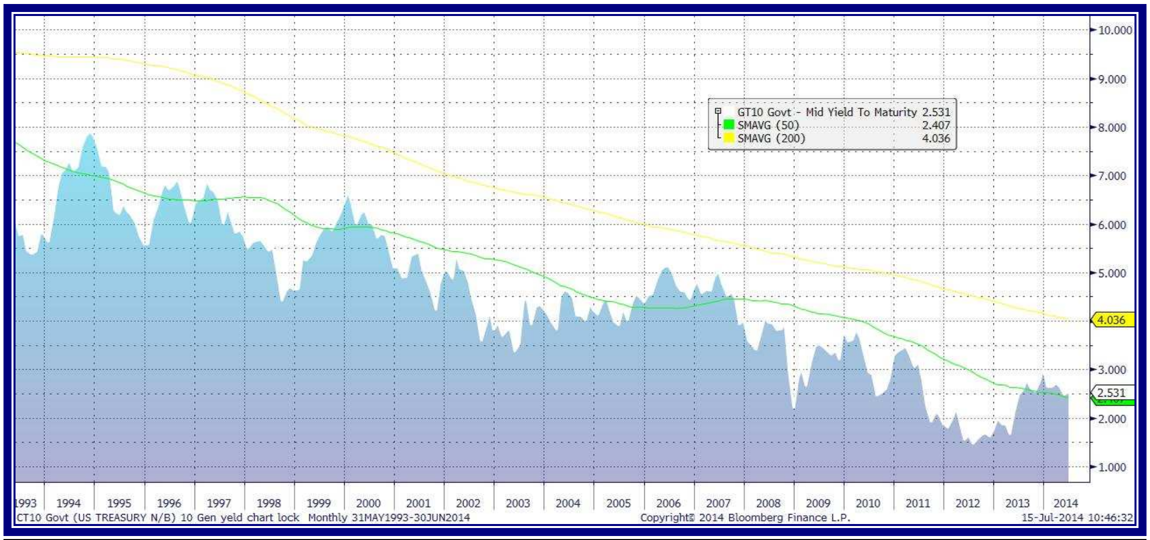
Government Bonds

The U.S. Treasury Department sold $15 billion in 10-year inflation-indexed notes (Tips) on July 24th. The offering will raise all new cash, the Treasury said. Inflation-indexed securities are intended to provide investors with a hedge against inflation. The securities rise or fall in value with movements in the government's consumer price index, with a three-month lag. The securities also let the Treasury lower its cost of borrowing in periods of tame inflation. Inflation-indexed notes rise or fall in value tracking changes in the consumer price index calculated by the Labor Department. Inflation adjustments will be added to the notes' principal and be payable at maturity.

Fed Chair Janet Yellen did testify in front of Congress that monetary stimulus is still merited, while interest rate increases may occur sooner if the economy accelerates. "If the labor market continues to improve more quickly than anticipated," then increases in the federal funds rate target likely would occur sooner than currently envisioned, Dr. Yellen told the House Financial Services Committee. Yellen said the central bank plans to release stimulus-exit-plan details later this year.

Traders are forecasting a 60% chance the Fed will increase its key rate by July 2015, federal funds futures contracts show, down from 62.8% a month ago. The central bank has kept its target for the benchmark fed funds rate in a range of zero to 0.25% since December 2008. It last raised the fed funds target rate in May 2006.

Ten Year Generic Treasury Yield



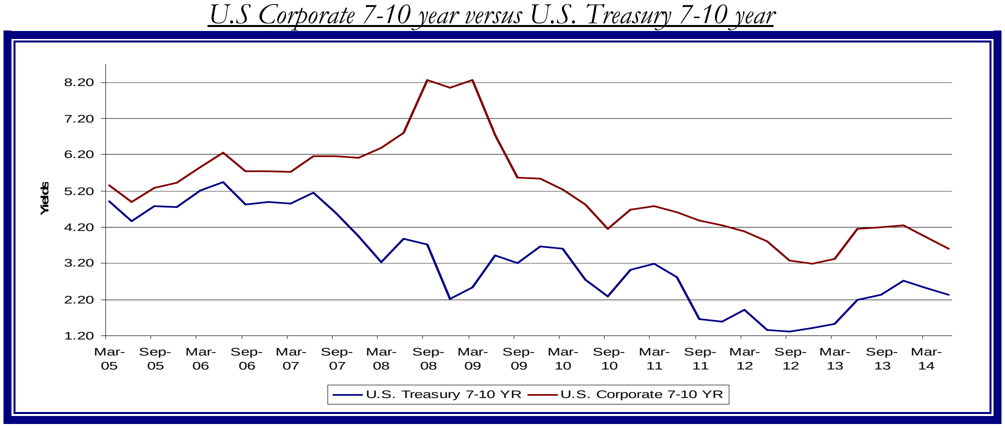
Source: Altman Investment Management Research and Bloomberg

Corporate Bonds

Investment-grade corporate bond yields and spread levels in late July were 2.93% and 99bps, respectively. Investors moved $2.4b into investment-grade corporate debt funds, the 30th consecutive week of deposits, despite predictions of a rise in benchmark yields by year-end, which would eat into the notes' returns.

In late July, the U.S. two-year interest-rate swap spread (a measure of debt-market stress) bumped up slightly to 19.00 bps, up from 16.75 bps the previous week. The gauge widens when investors seek the perceived safety of government securities and narrows when they favor assets such as corporate bonds. In the graph below, we look back on the spread level going back to the beginning of 2005, before the financial crisis began, for the 7-10 year treasury index versus corporate bonds. We conclude there is still sufficient investment opportunity in the corporate sector relative to previous spread levels.

U.S Corporate 7-10 year versus U.S. Treasury 7-10 year



Source: Altman Investment Management Research and Bloomberg

We continue to maintain an overweight position in investment grade (IG) corporate bonds relative to a market weighting. Overall, IG bond spreads have widened this month by 15 bps as a result of a significant fall in benchmark rates following the December employment data. While IG total returns will likely be modest, IG will achieve higher returns than government bonds due to their yield pickup and our understanding that the market should expect that credit spreads will incrementally tighten. We foresee a total return of 1% to 2% over the next six months, with lower IG rating segments offering better return potential than higher-rated issue.

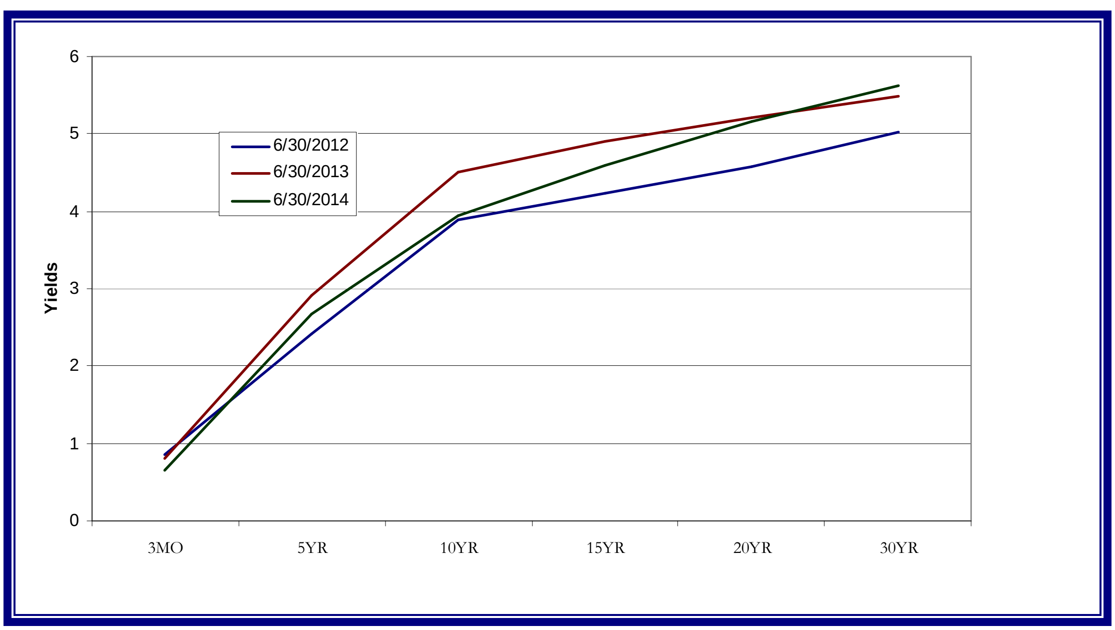
Municipal Bonds

Yields on short-term maturities five years or less have not budged. We believe that they won't likely move until the Federal Reserve decides to raise its short-term interest rate. Based on the Fed's recent statements, short-term rates are not likely to change until 2015 at the earliest. Short-term munis shouldn't be ignored completely, in our view, as they offer low interest rate risk and liquidity. Shorter-term muni bonds may still make sense for the short end of laddered portfolios. However, these instruments won't generate much income until the Fed increases its short-term interest rate.

Yields for longer-term AAA municipals have traded in a wider range, as compared to shorter-term municipals, over the past 52 weeks. Currently they are near the higher end of that range, while the intermediate and longer part of the curve appears attractive. Intermediate-term rates have already absorbed much of the Fed's slower pace of bond buying, in our view. It's also worth noting that just the mere mention of tapering during the summer of 2013 led to the significant rise in interest rates. Since December, when the Fed announced the taper, the yield on the 10-year MMA AAA municipal bond index has actually fallen from 2.93% to 2.82%.

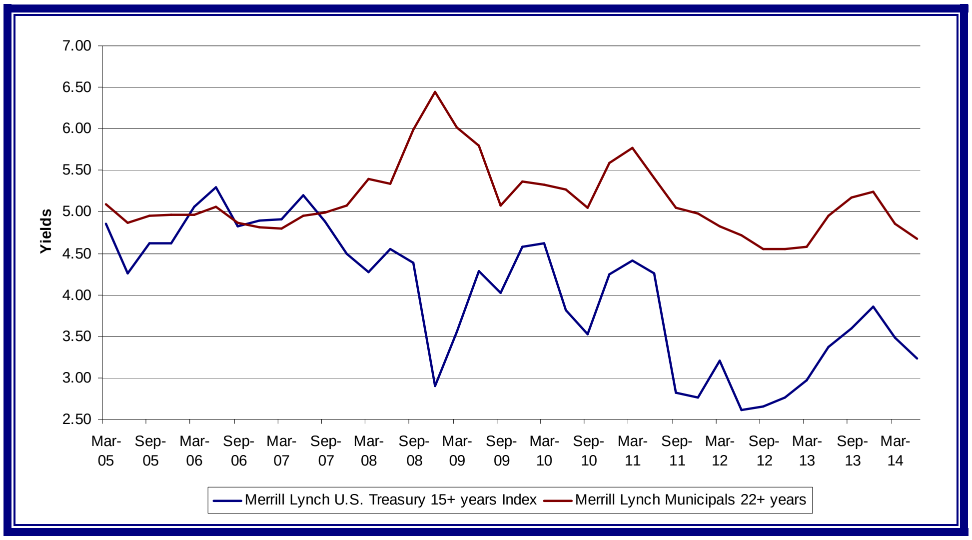
The second quarter of 2014 was a surprise in that rates continued to decline, generating positive returns for the market. Yields in the short end of the municipal curve, as represented by the BofA Merrill Lynch Municipal 1–10 Year Index (which we used to benchmark this segment of the market) increased by around 0.05% in the quarter. There continues to be very heavy demand for bonds with short maturities. The index returned 1.26% for the quarter. The yield curve flattened, but remains steeper than it has often been historically, so it's providing an incentive to extend durations. We've been resisting the temptation to extend, choosing instead to hold what we consider neutral durations, or those that are roughly even with our historical averages. We'd rather hold some dry powder that would allow us to lengthen durations if a sharp sell-off should occur.

Fair Market Yield Curve History: Generic Muni- General Obligation Insured Curves



Source: Altman Investment Management Research and Bloomberg

Long Term Municipal to Treasury Yield Spreads



Source: Altman Investment Management Research and Bloomberg

Summary:

The 10 year benchmark treasury outperformed the shorter maturities coming in at 6.1% for the first half versus .4% for the 2 year benchmark. Relatively lower quality issues such as corporates and high yield issues also posted strong returns above 5%. If bond yields rise as we expect, then performance in this arena may not end the year as strongly. That being said, the duration of our Fixed Income portfolios remain shorter than the "Intermediate Index" in this environment.

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