FIXED INCOME STRATEGY HIGHLIGHTS

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THE U.S. FIXED INCOME MARKETS

Brief Overview

There is no lack of uncertainty facing investors. Congressional wrangling over the budget followed by debt ceiling negotiations certainly aggravated markets in the third quarter - followed by the unanswered question of whether the Fed will begin tapering any time soon. And if so, by how much? The two issues are, of course, closely related with the Fed concerns that a monetary policy shift could be damaging while fiscal policy is stagnating. Other questions persist. Will the next Federal Reserve Chairperson alter monetary policy? Will Chairman Bernanke's attempt to provide transparency be curtailed or expanded? Are conditions in the Middle East improving or is this just a temporary lull before the next crisis erupts?

Adding to these uncertainties is the indeterminate impact of the Affordable Care Act. Will small firms limit hiring to avoid increased compliance requirements? Will the use of temporary employees increase? To what extent will health care costs be shifted from employers to employees? How will the overall cost and availability of health care be impacted? Our assumption is that the Act will have a marginal impact on hiring and disposable income.

Despite all the turbulence, the economic fundamentals appear to support stable but moderate growth, limited inflation, and a relatively high unemployment rate. A continuation of real GDP growth in the 2.0-2.5% range is likely over the foreseeable future.

Chairman Bernanke's comment earlier in the year - that the Fed's $85 billion per month of Treasury and agency securities purchases could be tapered this fall - caused yields on longer maturity securities to jump. This move occurred almost instantaneously, by forty to fifty basis points. In the case of the ten year Treasury the move started from the 1.66% interim low reached in May. This initial move was followed by additional rate increases through mid-September that resulted in an intraday peak rate of over 3% on the ten-year government bonds. The Fed's subsequent announcement after the September FOMC meeting, that tapering was not yet in their game plan, prompted a rally during the closing weeks of last month. The yield on the ten year Treasury closed September at 2.64%.

We are anticipating a very gradual increase in longer term interest rates again over the next six months, as the end of QE approaches and economic data remains somewhat constructive. There is less ambiguity in corporate credit, in particular the lower-rated segment. A moderately stronger economy and prolonged expansionary monetary policy are both supportive of higher yielding bonds, keeping interest rates and default rates low. We continue to overweight U.S. investment-grade over government bonds.

Janet Yellen, vice chair of the Federal Reserve, was officially nominated by President Obama to succeed Ben Bernanke as Chairman. Her confirmation is expected to be the next big Fed event. Data uncertainties after the prolonged U.S. government shutdown and anticipation of a delay to Fed tapering have resulted in lower short- and long-term Treasury yields since the quarter's close.

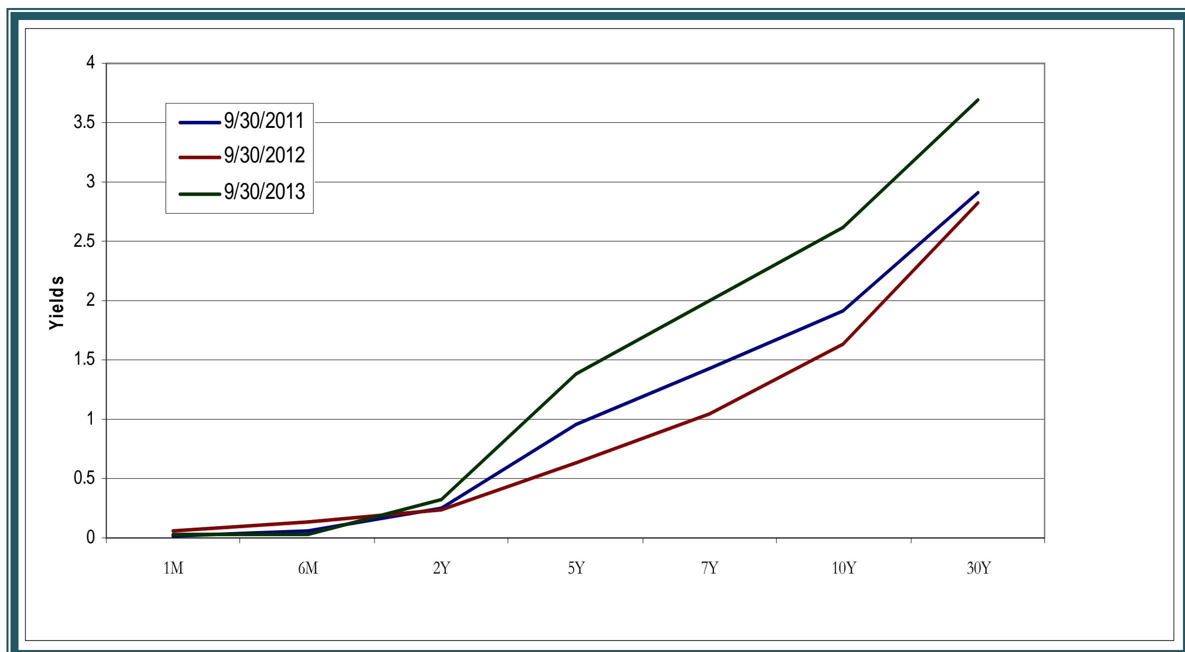
However, we believe the loss in economic momentum will only be temporary, with growth indicators picking up again. Benchmark yields should therefore resume their uptrend over three to six months. In the taxable market, we continue to favor investment grade corporate bonds, as this asset class should benefit from continued Fed accommodation. We also anticipate more cautious behavior on the part of corporate managers due to the continued political uncertainty. On a tax-equivalent basis, tax exempt municipals continue to offer noteworthy value. We believe that municipal bonds are poised to perform a bit better in the near term, as the weakest segment of the market may have stabilized for now and forward supply estimates are below their 12-month average.

Rate Volatility Likely to Persist

Given the uncertainty surrounding the government shutdown in early 2014, and the looming debt ceiling debate, we expect that the fixed income markets will continue to be volatile. Also overhanging the market is the fact that the Fed, despite the recent reprieve, will ultimately have to taper. Action by the Fed may be delayed for a significant period of time, but accommodation will ultimately be reduced. Another rate advance is possible when this happens. Volatility is also being affected by reduced market liquidity. Lower capital allocations to trading desks have caused dealer inventories to be pared and bid/ask spreads to widen. All fixed income markets have been impacted, but the effect is amplified in the municipal sector where hedging is extremely difficult. The good news is that volatility provides opportunities that can be taken advantage of by bond managers. Duration adjustments, or taking advantage of cheap sectors of the market, have the potential to provide return enhancements.

EXHIBIT I

Active U.S. Treasury Yield Curve



Source: Altman Investment Management Research and Bloomberg

Third Quarter Performance

The third 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): .53%
- **Short-term U.S. Treasuries** (Bank of America 1-3 Year U.S. Government Index): .29%
- **Intermediate-term U.S. Treasuries** (Bank of America U.S. Government Intermediate Index): .42%
- **Long-term U.S. Treasuries** (Bank of America U.S. Government Long Index): -2.68
- **TIPS** (Bank of America U.S. TIPS Index): .63%
- **Mortgage-backed securities** (Bank of America Mortgage Index): 1.08%
- **Municipal bonds** (Bank of America Municipal Bond Index): -.41%
- **Corporate bonds** (Bank of America Corporate Investment Grade Index): .89%
- **High yield bonds** (Credit Suisse High Yield Index): 1.48%

EXHIBIT II

10-Year Generic Treasury Yield

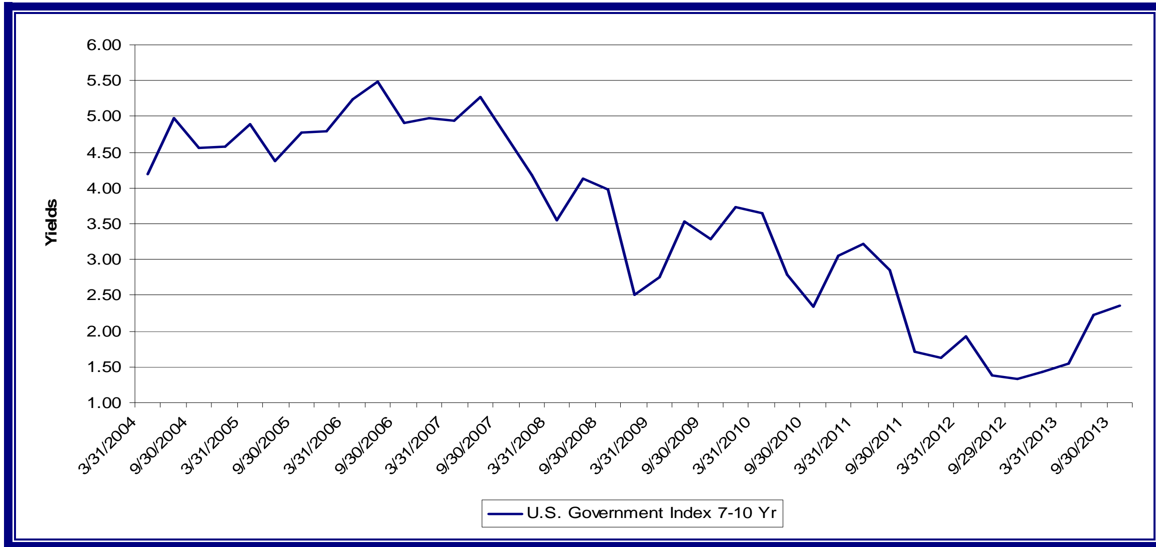
Source: Altman Investment Management Research and Bloomberg

Government Securities

The market now expects some Federal Reserve tapering in March 2014 instead of in December. We don't foresee much of an uptrend in rates over a six month horizon. Over the following three months, our yield forecast for 10-year Treasuries is from 2.5 - 2.8% and we think that downward pressure on yields could continue in the very near term. But we are keeping our 6-month forecast of 2.8% and our 12-month forecast of 3.0%, as we expect growth to slowly accelerate in the middle of 2014. We anticipate some Fed tapering within that time frame, and we don't expect the next budget fight in January to be anywhere near as contentious as this year's.

EXHIBIT III

U.S. Government Index 7-10 year



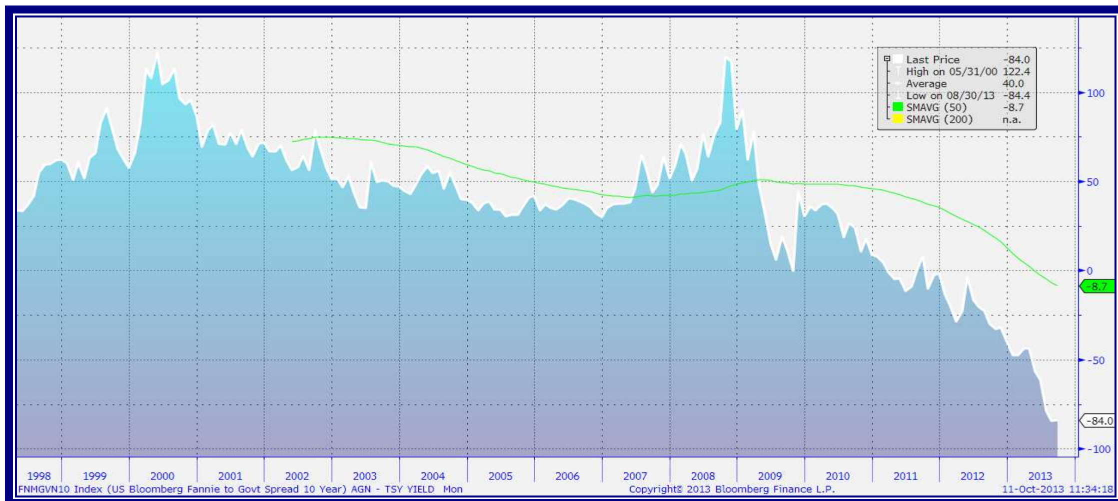
Source: Altman Investment Management Research and Bloomberg

Corporate Securities

We continue to hold an overweight position in investment grade (IG) corporate bonds, relative to government bonds and government mortgage-backed securities. Overall, IG bond spreads tightened by 7bps last month and the significant fall in benchmark rates following the debt ceiling resolution caused IG yield levels to decline by 10bps to 3.2%. 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 issues.

EXHIBITI IV

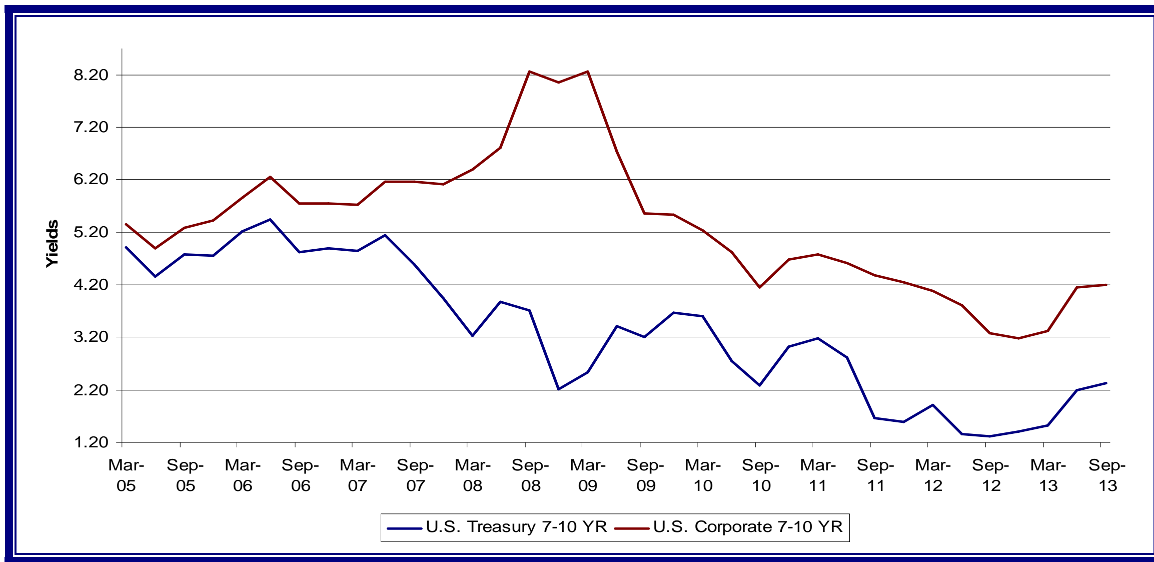
10-year U.S. Agency (Fannie Mae) Yield minus 10-year Treasury Yield



Source: Altman Investment Management Research and Bloomberg

EXHIBIT V

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



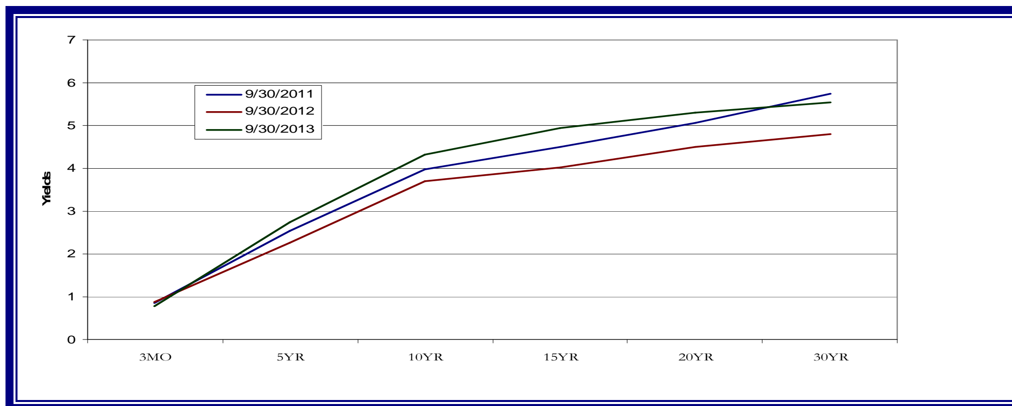
Source: Altman Investment Management Research and Bloomberg

Municipal Securities

Following a lengthy period of volatility, illiquidity, and negative returns, the municipal market appears to have stabilized over the past two months. This is especially true in the higher-rated intermediate sector. However, recent muni performance has not kept pace with the stronger rally occurring in the Treasury bond market. Puerto Rico bonds are showing notable price gains as the negative sentiment appears to be waning a bit, in the wake of the Government Development Bank's investor webcast. Meanwhile, mutual fund outflows continue to occur in municipals. At current levels, we believe munis may still attract nontraditional buyers to the sector and we foresee moderately better performance in the near term. The current AAA 10-year muni-to-Treasury yield ratio is 102.0% (last month: 97.3%). When the municipal/Treasury ratio exceeds 80%, then municipals are considered "cheap". Although the current ratio is high, it's not the record high reached during the credit crisis in late 2008 when the 10-year municipal/Treasury ratio jumped to 186%. By June of 2009, the ratio had dropped back to the historic norm of 80%.

EXHIBIT VI

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



Source: Altman Investment Management Research and Bloomberg

EXHIBIT VII

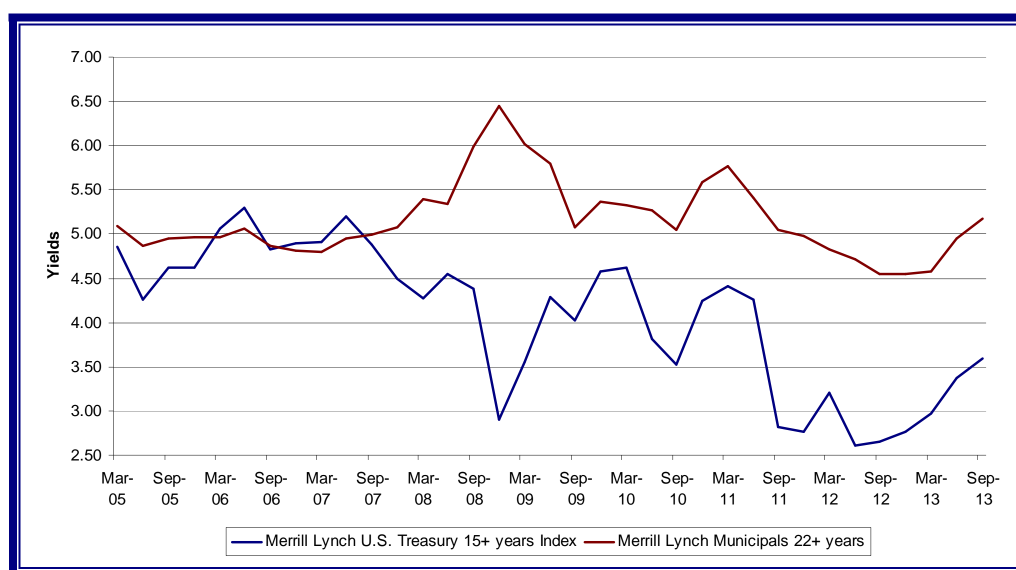
Fixed Income Sector Performance – Q3-2013

Fixed Income Sector Performance – 2013 Q3- Sector	Rating	Maturity	Duration Mod Adj	Yield	Spread	Price Spread Avg	Trailing12 Months - Total Return
Treasury	Aaa/AAA	7.0	5.5	1.4%	N/A	$104.7	(2.5)%
Agency	Aaa/AA+	4.9	3.9	1.32%	80	$105.1	(1.4)%
MBS	Aaa/AAA	6.4	5.1	2.9%	150	$104.3	(1.1)%
Municipal	AA/Aa	14.4	5.2	2.9%	150	$100.8	(2.3)%
Corporate	A2/Aa	9.4	6.3	2.9%	150	$106.6	(1.7)%
High Yield	B1/B	6.6	3.9	6.0%	460	$103.4	(6.1)%

Source: Altman Investment Management Research and Bloomberg

EXHIBIT VIII

Long Term Municipal to Treasury Spreads



Source: Altman Investment Management Research and Bloomberg

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