FIXED INCOME STRATEGY HIGHLIGHTS

FEBRUARY, 2012

Written By: *Peter J. Altman, President*
Jeffrey S. Bauman, Managing Director
Karen Troiano, Senior Portfolio Manager

34 Chambers Street
Princeton, NJ 08542
T 609.252.0048; F 609.497.3246
www.AltmanInvest.com

THE U. S. FIXED INCOME MARKETS

Brief Overview

Falling inflation in the developed world promoted a climate of low interest rates in 2011. This supportive backdrop, in conjunction with a safe harbor in reaction to the Middle East, the Eurozone debt crisis, equity market volatility and partisan infighting in Washington, all caused a rush into fixed income securities during the year. Of course this kind of rally has the effect of limiting investment opportunities for portfolios searching for yield. The ten-year Treasury traded at close to 3.4% at the end of 2010 and closed the year at under 2.0%, after bottoming at 1.72% in late September. Double digit principal returns were recorded in many long dated maturity segments of the fixed income markets.

EXHIBIT I

Ten Year Generic Treasury Yield

Source: Altman Investment Management Research and Bloomberg

We expect bond yields to be largely capped around recent ranges and to trend slightly higher in some regions like the US and Japan, but definitely lower in Europe. High-quality conventional government debt is poised to outperform inflation-linked securities. Nominal debt is not only likely to generate better returns as inflation expectations decline, but also because linkers typically fail to benefit from flight-to-quality demand. During periods fueled by heightened volatility and broad uncertainties, bond investors tend to place a greater premium on liquidity, not inflation protection.

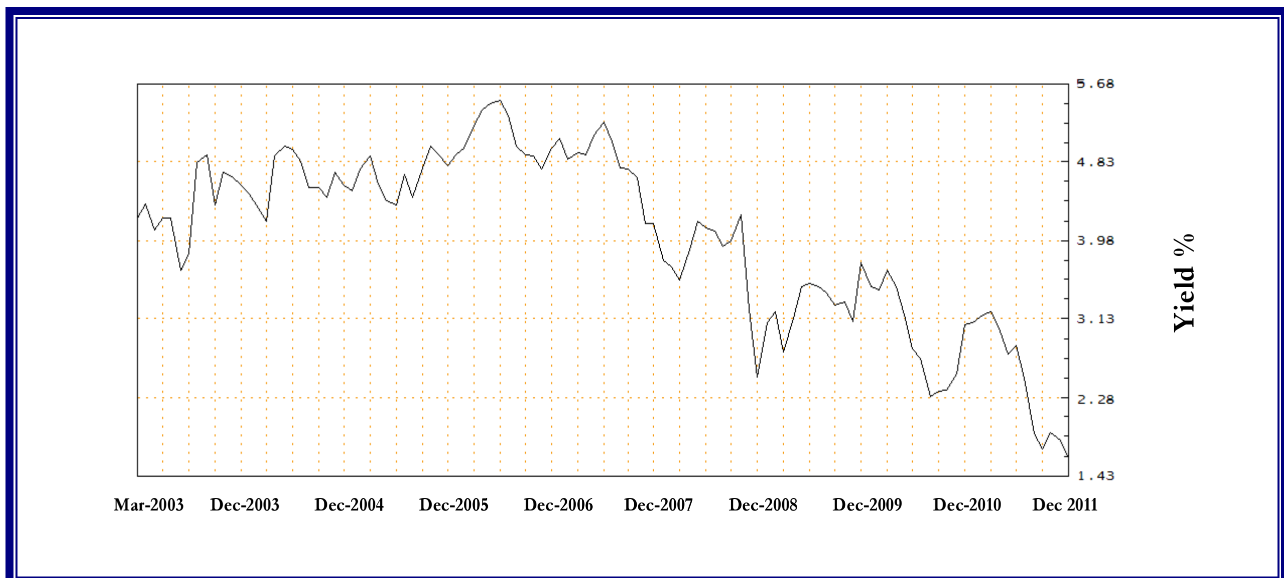
While inflation is still relatively high in many emerging economies, slowing growth and falling food prices should contain interest rates and bolster the case for monetary policy. For example, China eased its banks' reserve requirements on December 5th and Brazil's central bank cut the overnight rate for the third straight meeting since August.

The recent rise in German Bundesbank yields (and other "core" European AAA rated countries) reminds investors that the meaning of "risk-free" government debt is currently being recalibrated. Elevated credit default swaps (CDS) for highly rated European sovereigns are a reflection of deep burden-sharing concerns as the periphery crisis escalates. Italy, Belgium and France trade at historically high CDS levels, which has fueled record borrowing costs in the cash bond market. The gap between Germany and United States CDS is historically wide, and 10-year Bund yields are higher than U.S. 10-year Treasuries for the first time since the middle of the financial crisis in 2009.

Government-Related Debt/MBS

EXHIBIT II

7-10 Year U.S. Treasury/Agency Yield



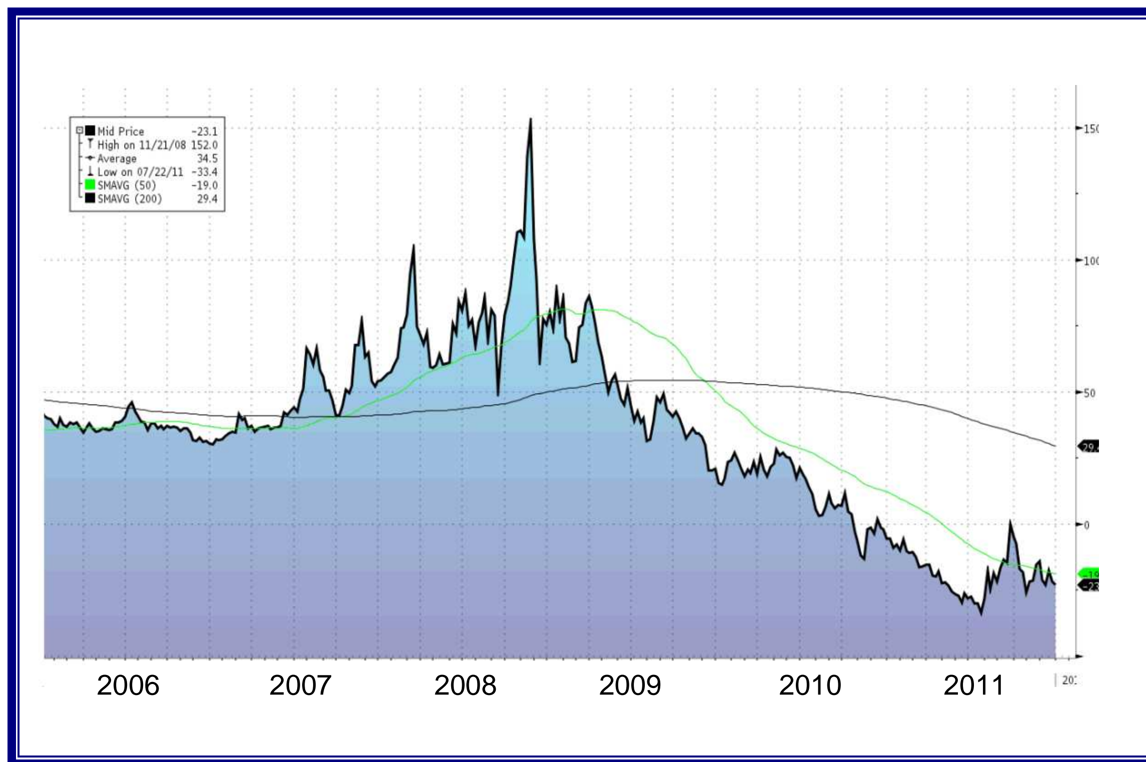
Source: Altman Investment Management Research and Bloomberg

As we know, U.S. government bond yields are not dictated by ratings actions. Instead, the Federal Reserve governs levels at the front end of the curve while inflation expectations and demand determine the long end. In our view, interest rates are not moving anywhere with the Fed committed to rock bottom policy rates through mid-2013 and inflation pressures muted. As for demand, here's a little known fact—by the end of Operation Twist (the Fed's program to swap $400 billion of its short-dated Treasury debt for longer-term securities announced on September 21st) the central bank will own approximately 30% of long-dated (6-year to 30-year) Treasuries outstanding. This should further inhibit any rise in long-term U.S. bond yields. If economic conditions don't improve materially, we expect the third round of quantitative easing (QE3) to commence in the U.S. next year. The decision to reinvest maturing debt from the Fed's $2.8 trillion balance sheet into agency mortgage-backed securities (MBS), which was announced with Operation Twist, opened the door for outright purchases of mortgage debt in QE3. Even if QE3 does not come to pass, agency MBS spreads are attractive and prepayment risks are low despite the recent launch of the Home Affordable Refinance Program (HARP 2.0), the enhanced U.S. government program to assist troubled homeowners.

Supranational/U.S. agencies should outperform as valuations are historically attractive; we prefer medium-dated U.S. agencies, callable Government Sponsored Enterprise (GSE) debt and non-European supranational. We continue to favor Agencies versus Treasuries. Five year Agency spreads to Treasuries are still 15 basis points wide to our estimated fair value, with the ten-year spreads as high as 40 basis points. It would appear that investors are getting paid for the duration risk.

EXHIBIT III

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



Source: Altman Investment Management Research and Bloomberg

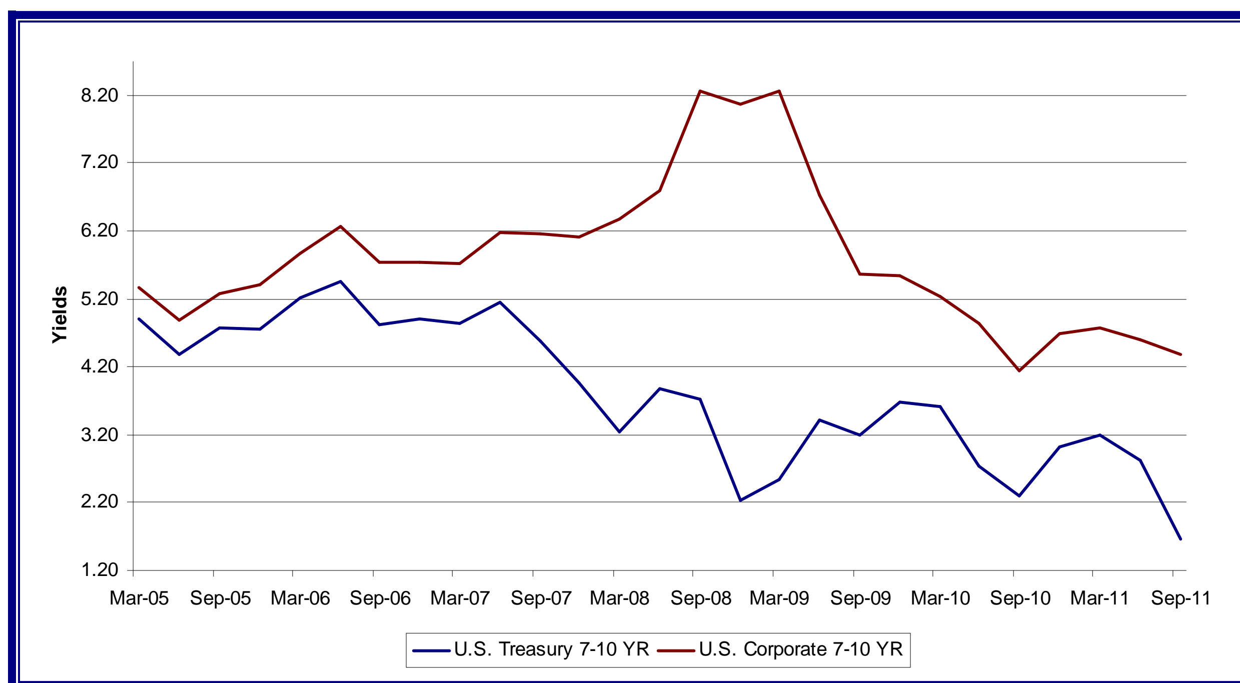
High-Grade Corporates and Preferreds

Our strongest conviction in fixed income continues to be long-dated high grade corporate bonds. We favor non-financial issuers in the U.S., where fundamentals are solid, balance sheets are strong and liquidity is robust. While slowing growth will compress profits, these companies feature much-improved balance sheets, record cash balances and low financing requirements. Financial metrics are broadly even healthier than pre-crisis levels. For example, net debt to EBITDA* among non-financial issuers has continued to reach new lows as companies reduce debt burdens and refinance existing borrowings into longer-dated (and lower coupon) obligations. Given our expectation for low rates to continue through next year, we estimate that USD high grade corporates should again generate good returns (with the majority of those gains due to carry, or coupon). Our favorite defensive sectors include cable/media, chemicals, health care, tobacco and food. Each features issuers that have strong cash flows, stable operating results and are likely to be more resilient than even higher quality financial issuers, as economic uncertainties persist.

* Earnings before interest, taxes, depreciation and amortization.

EXHIBIT IV

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



Source: Altman Investment Management Research and Bloomberg

We continue to remain cautious - even among the highest quality issuers that retain manageable exposures to European peripheral debt - and emphasize adding additional debt exposure in nonfinancial corporate bonds employing high coupon strategies in our portfolio construction. These securities have defensive characteristics that dampen price declines in rising rate environments and the risk becomes de minimis. Buyers tend to be reluctant to purchase premium bonds with high dollar prices. We prefer high coupon bonds that trade at higher yields to call prices than par bonds that are priced to maturity. The advantage of buying high coupon in the five-year maturity with a six month call results in a yield pick up of 30 basis points to the call.

The attractiveness of purchasing callable bonds is that if these bonds do not get called, the return for one year rises to the yield of a longer dated bond with less volatility. If the bond goes to a second year, the return stays intact. If the issue remains outstanding until maturity, the annualized return continues to outperform non callable securities. The investment generates superior cash flow relative to the coupon.

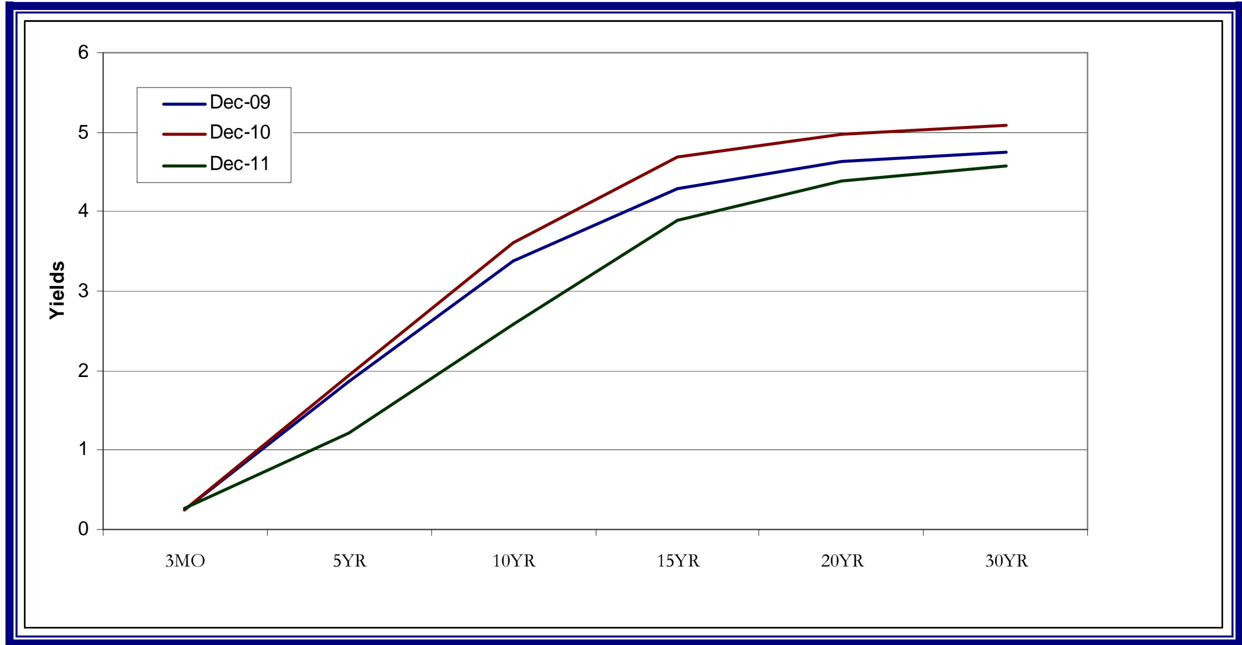
Municipal Bonds

Municipals followed the lead of the Treasury market. As shown in Exhibit V, the curve depicts how general obligation tax exempt yields declined throughout the year. Similar to 2011, issuance over the first few weeks of 2012 is running at about half of historical levels. Approximately $295 billion new bonds were sold last year, close to a ten-year low and a 32% drop from the record volume in 2010. The relative dearth of bonds in the market has been exacerbated by inflows into municipal bond funds of $5bn and sizable reinvestment capital. We expect the upcoming $5bn in new issuance will meet a better reception after the recent moves to higher yields in the high-grade scale. We expect issuance to continue to be structured with lower coupons and shorter maturities.

One aspect of issuance that might not be sustainable is the severe shortage of 25-year-plus supply. This reinforces our view that investors should resist the temptation to reach for yield by extending that far out on the curve, given that the flat curve does not compensate for the increased credit, term, and extension risk.

EXHIBIT V

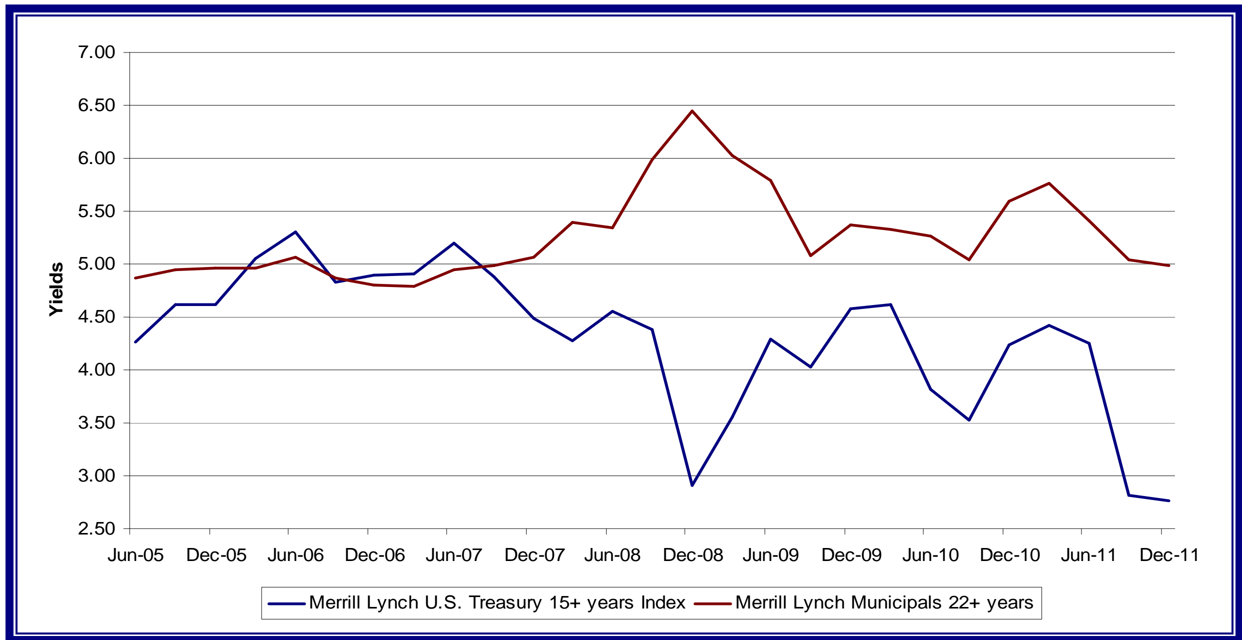
Fair Market Yield Curve History: Generic Muni- General Obligation Insured Curves



Source: Altman Investment Management Research and Bloomberg

EXHIBIT VI

Long Term Municipal to Treasury Spreads

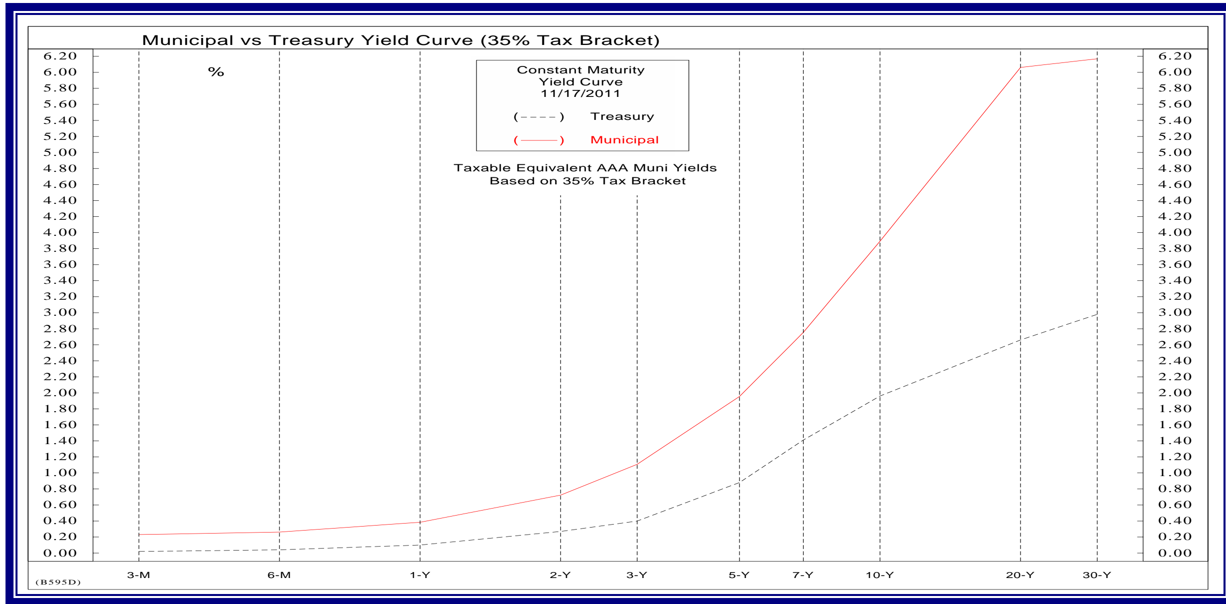


Source: Altman Investment Management Research and Bloomberg

To reiterate for our bond and balanced investors, our traditional accounts are measured against the Merrill Lynch 1-10 Year Domestic Master and have an average duration of 3.4 years and an average maturity of approximately 5 years. Both products have a conservative orientation that controls risk in the form of volatility. Our primary objective in managing these assets is not to incur total return losses in any year. Limiting portfolio durations provides us with the confidence that this objective will be met.

EXHIBIT VII

Municipal to Treasury Yield Curve (35% tax bracket)



Source: Ned Davis Research

EXHIBIT VIII

Treasury/Tax Exempt/Yield Relationship

	As of 9/30/11			As of 12/31/11		
	Munis	Treasuries	Ratio	Munis	Treasuries	Ratio
4-6 Years	1.7 %	.9%	188%	1.6%	.8%	200%
8-12 Years	3.0%	1.9%	158%	2.5%	1.6%	156%
22+ Years	4.0%	2.9%	138%	4.0%	2.8%	143%

Source: Bloomberg and Altman Investment Management, LLC
** Merrill Lynch Global Index- Investment Grade*

FIRM UPDATE:

Altman Investment Management is celebrating its eleventh year managing investments for our valued clients. We remain dedicated to servicing our investment partners in good and more difficult times, by achieving both consistent and superior investment performance relative to our benchmarks across both equity and fixed income classes. Our singular focus on investment performance and exceptional client service, with seasoned investment professionals, continues to solidify our long-term partnerships. We recognize that over the past decade it has not been particularly easy to stay the investment course, especially during volatile periods in the markets. During these periods of uncertainty, we especially appreciate our clients and business partners for their continued confidence in our process and expertise. We look forward to celebrating our twenty year anniversary with the same degree of energy and passion as on our first day of incorporation.

The opinions expressed in this commentary are those of Altman Investment Management, LLC as of the date appearing on this material only and are subject to change. The material is based upon information we consider reliable but we do not represent that it is accurate or complete and should be relied upon as such. This material does not take into account the particular investment objectives, financial situation or needs of the individual client and should not be viewed as an endorsement of any particular investment. Certain investments give rise to substantial risk and are not suitable for all investors.