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# Fixed Income Market Update

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JAG Advisors

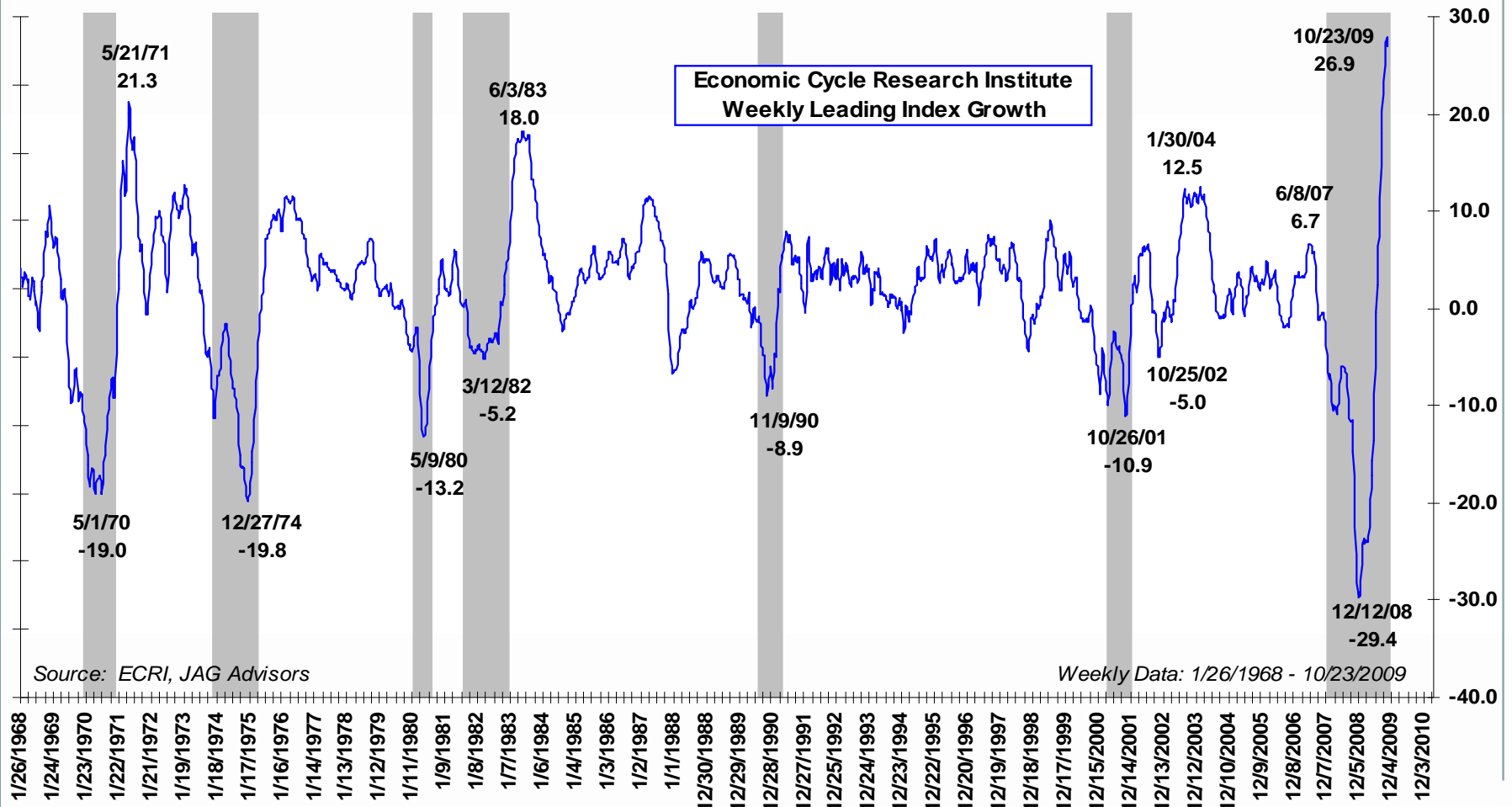
October 2009



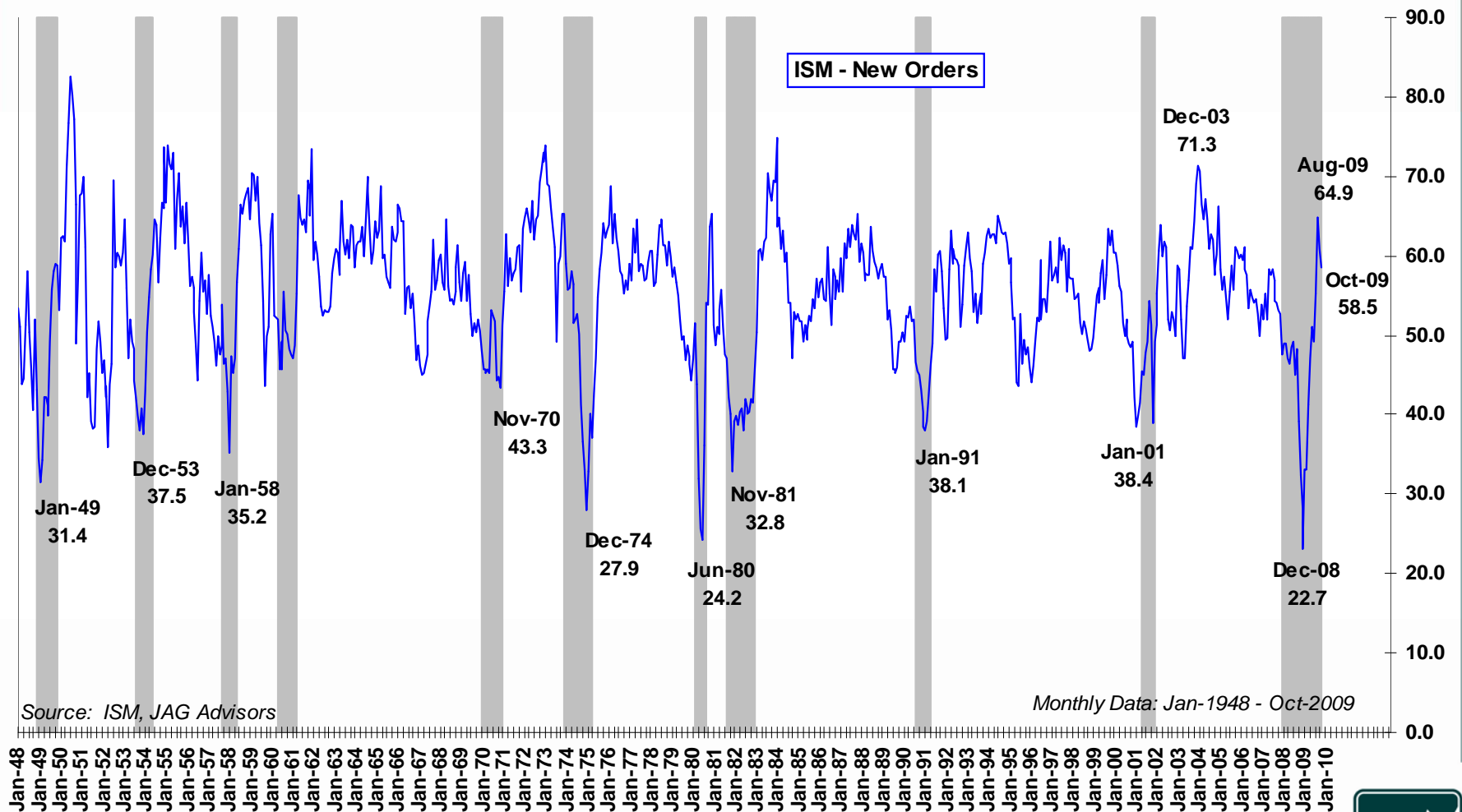
# Overview

- Economic outlook remains muddy, but “green shoots” are multiplying
- Credit spreads have tightened significantly since late 2008/early 2009
  - Spreads are generally *at or below* pre-Lehman levels
  - ... But they remain *above* levels following the Long-Term Capital crisis and 9/11
- Focus of investor concerns is likely to shift over coming 12-24 months
  - Chief worry of 2008/2009: credit risk
  - Chief worry of 2010 to 2011: interest rate risk
- Portfolio positioning
  - Stay short/intermediate
    - Concentrate maturities at belly of the curve versus either end
  - Stay diversified
    - Laddered portfolio with ample industry/sector/security diversification
    - Limited allocation to below investment grade securities
    - Reach “short” for premium yield opportunities
    - Avoid long-duration yield plays
  - Quality is important, but “real” quality is *more* important
    - Fundamental analysis versus blind adherence to ratings agencies
    - Business transparency: focus on simple stories
    - For distressed issues: focus on prospective discounted recovery value
  - Stay “boring”
    - Fixed income investing should *not* be exciting
    - Trading friction remains high...Limit portfolio turnover in favor of buy-and-hold

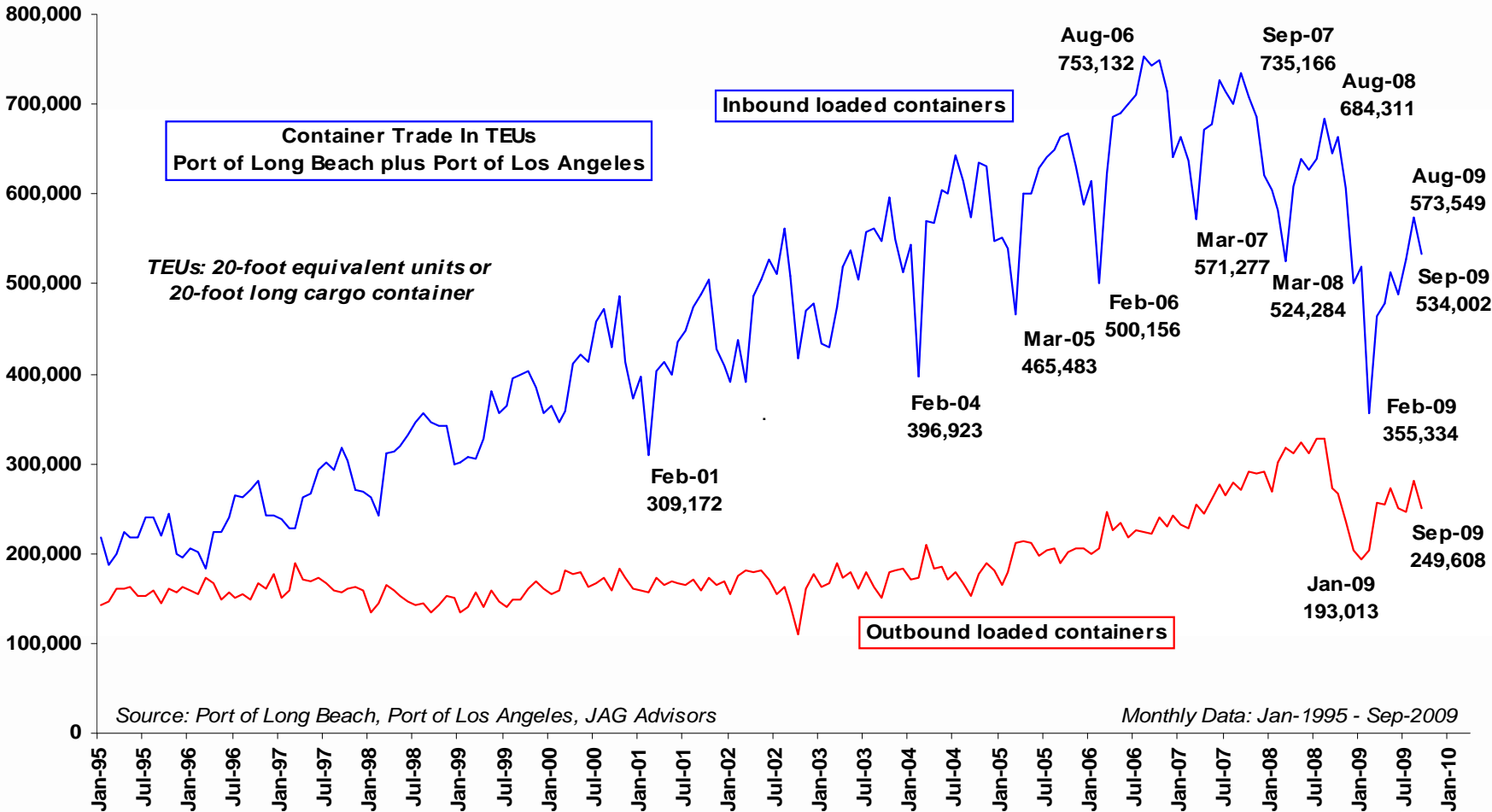
# ECRI Leading Index = *Highest in 40+ Years*



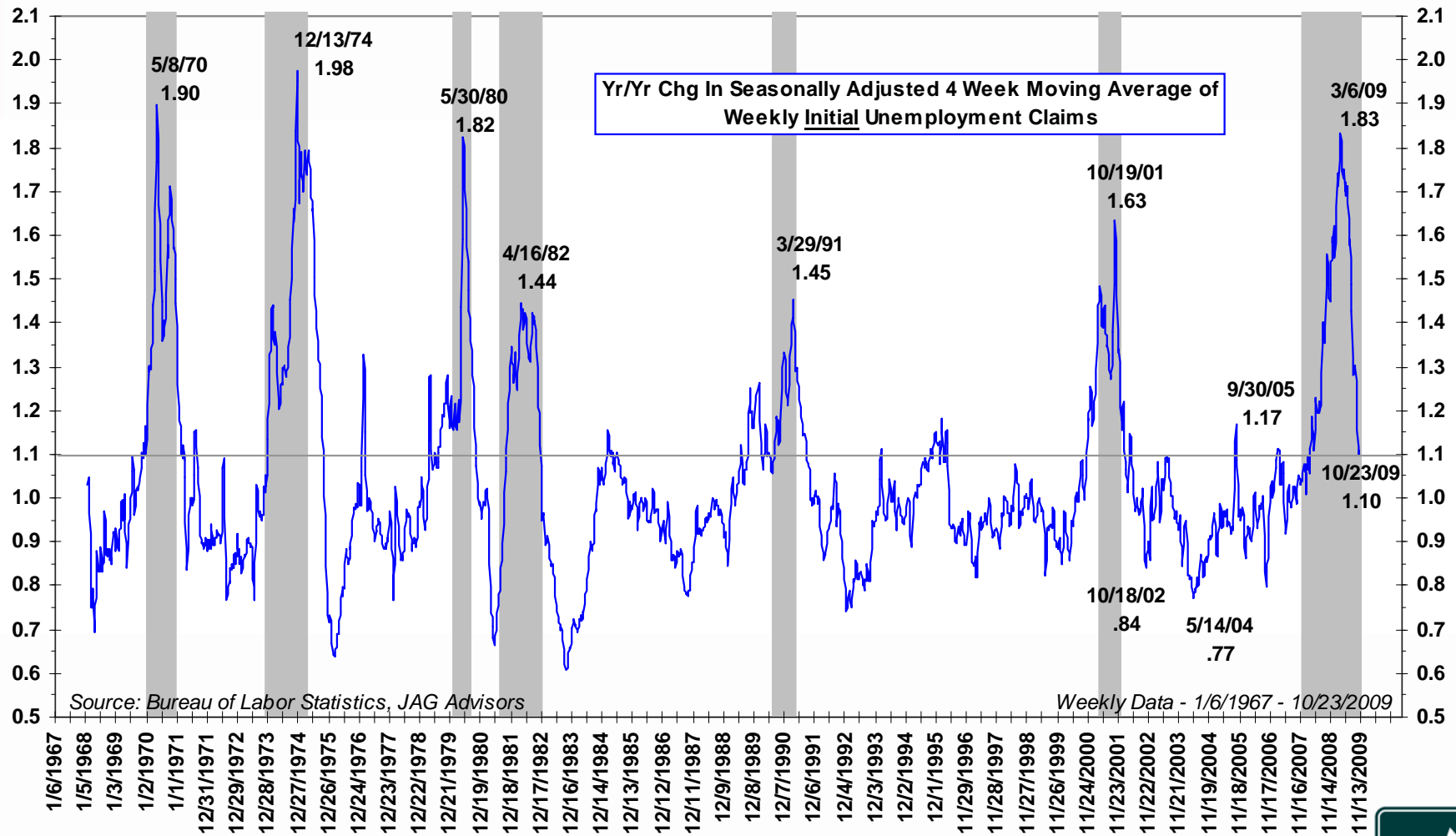
# ISM New Orders Index Holding Above 50



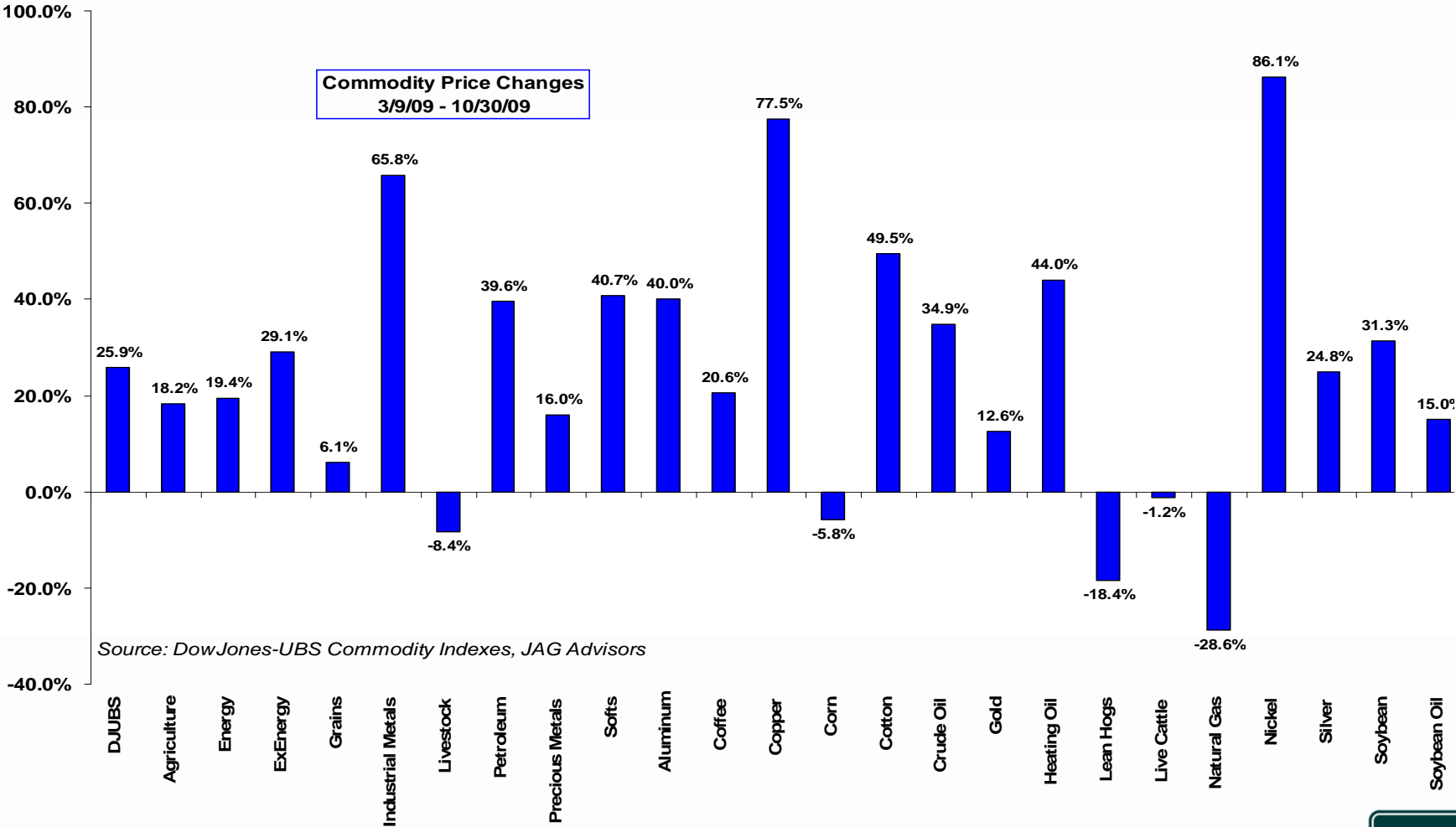
# Container Activity Ticking Up



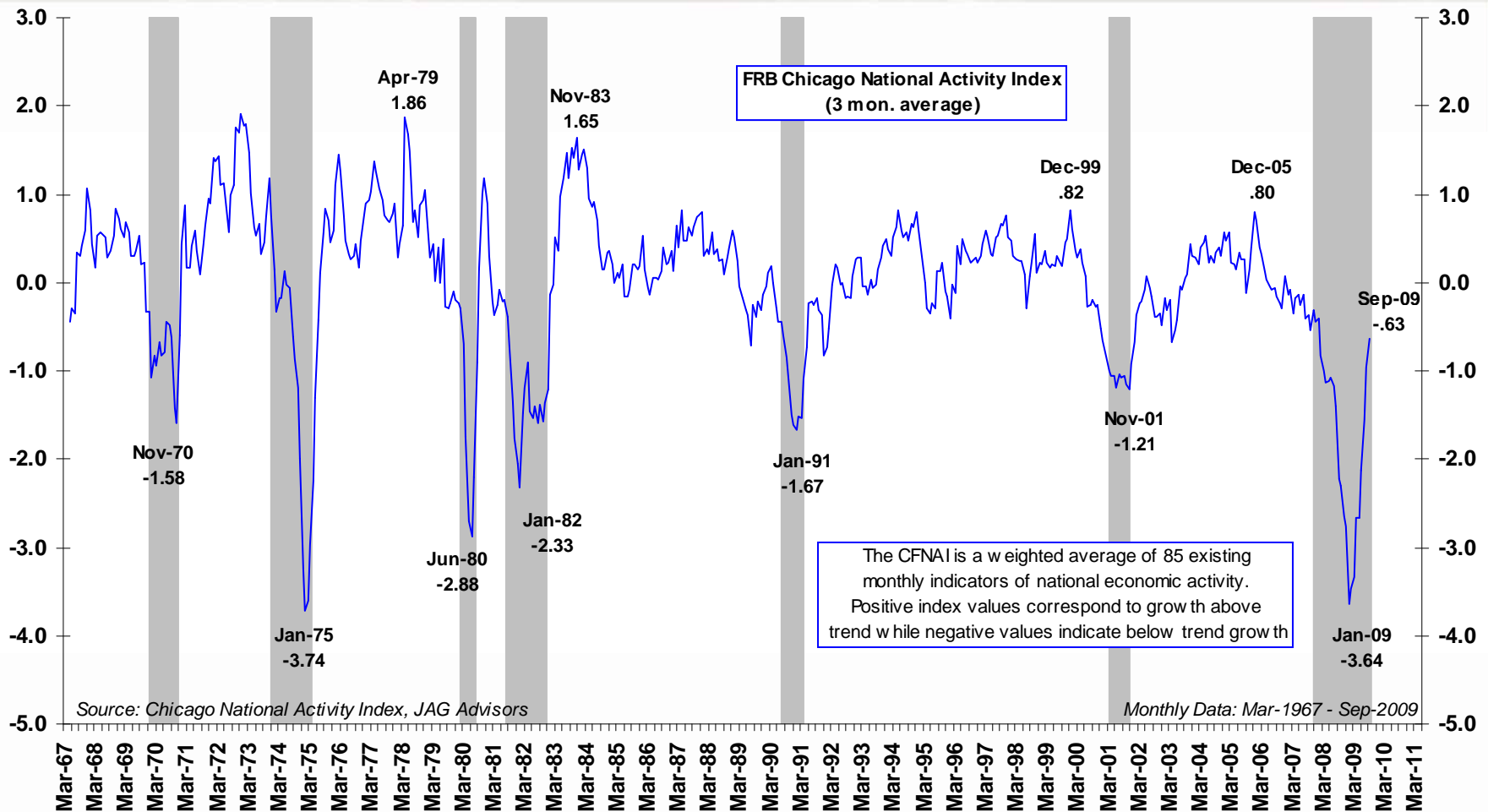
# Initial Jobless Claims Peaked In March



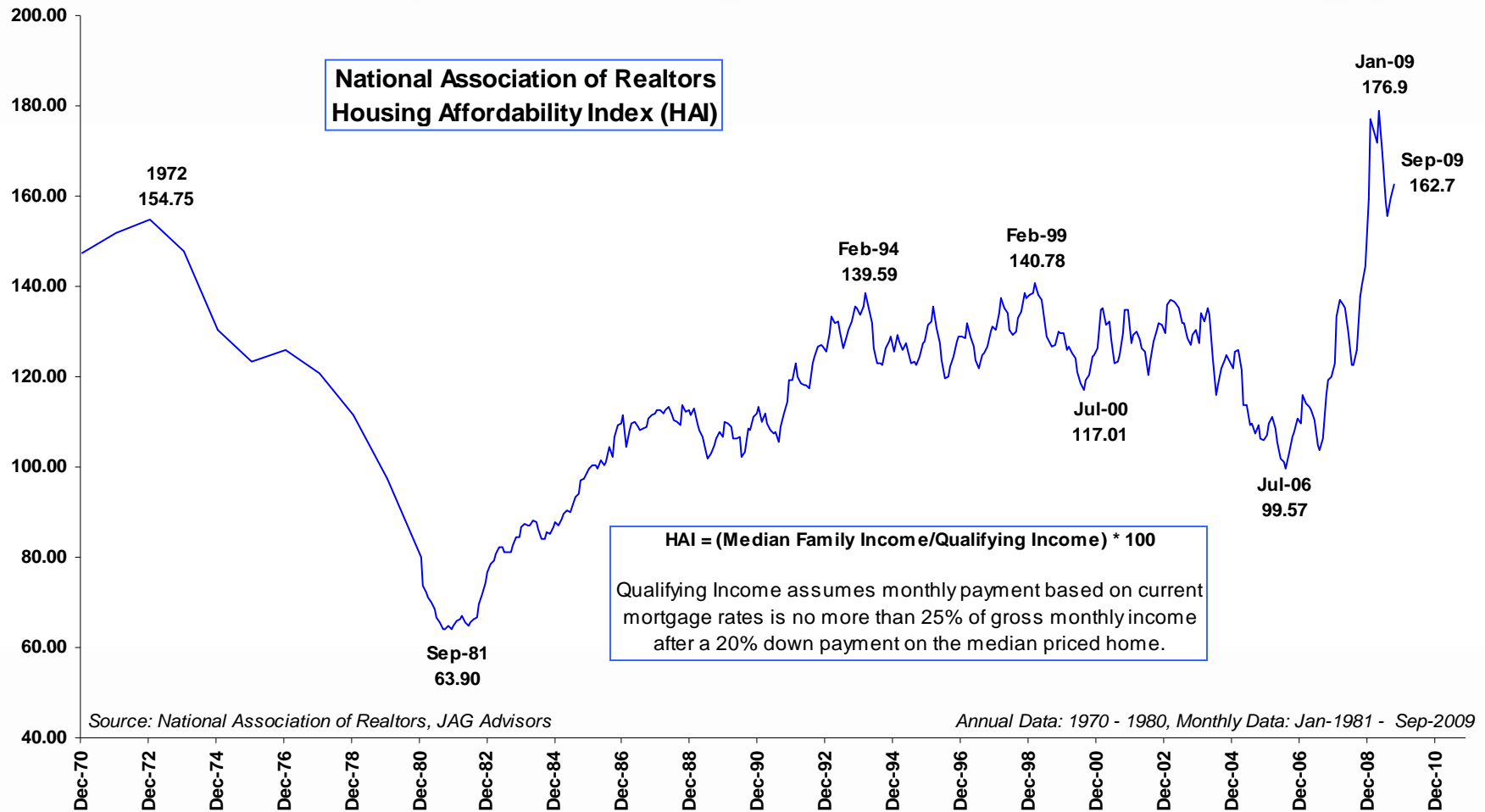
# Signs of Life in Commodity Prices



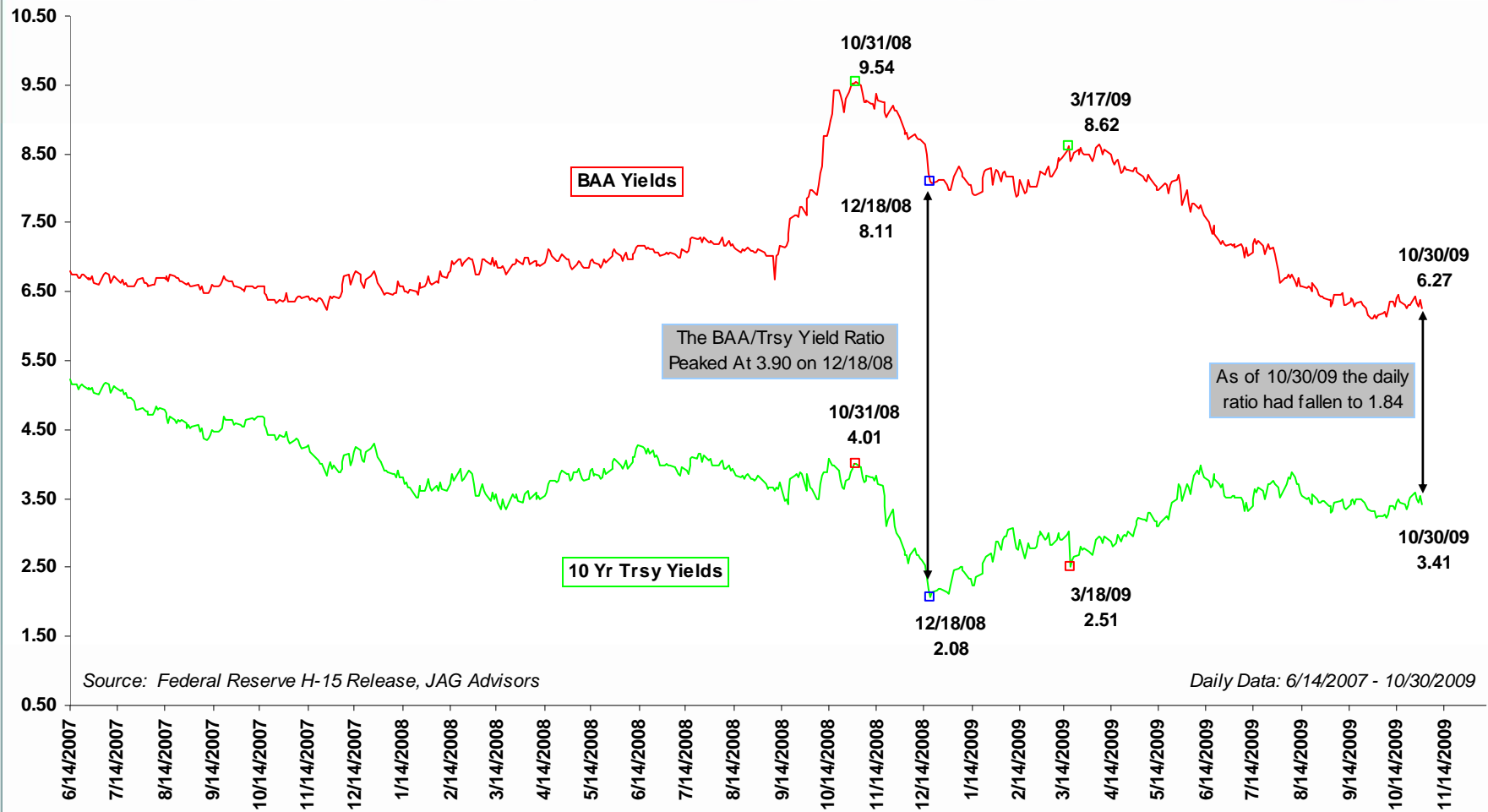
# CFNAI Continues to Improve



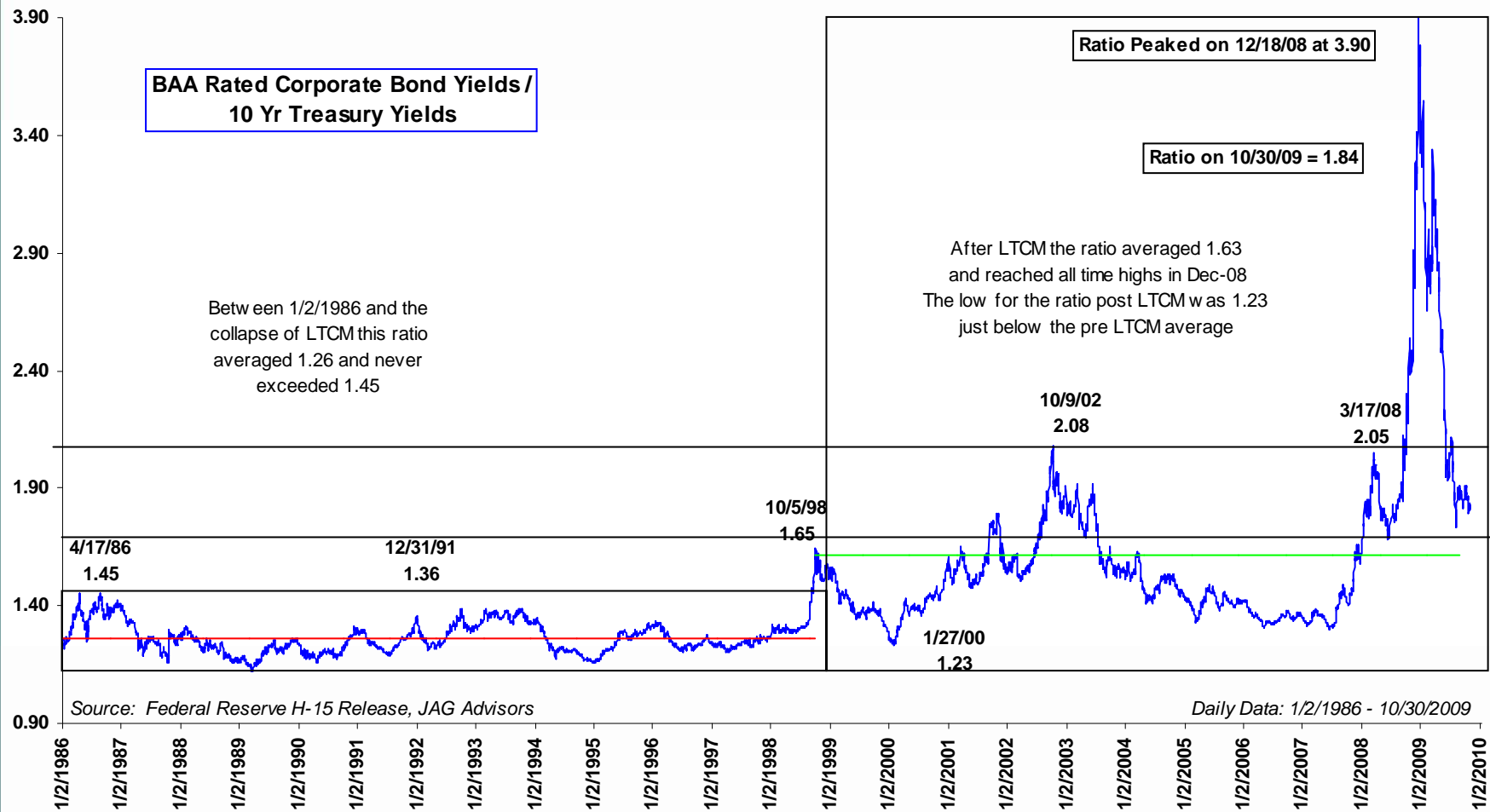
# Seeds of A Recovery – Home Affordability



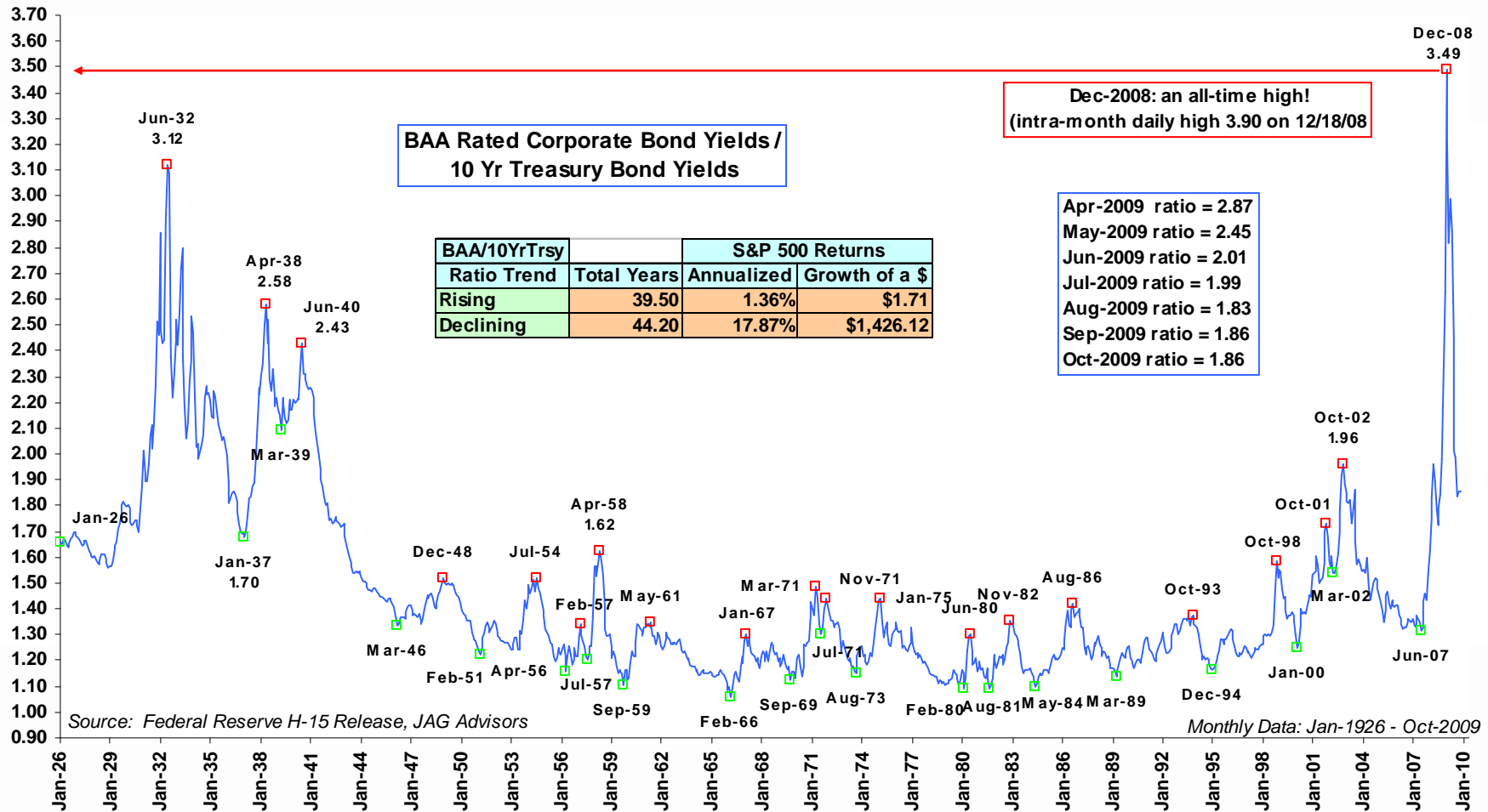
# BAA Yields Down, Treasury Yields Up



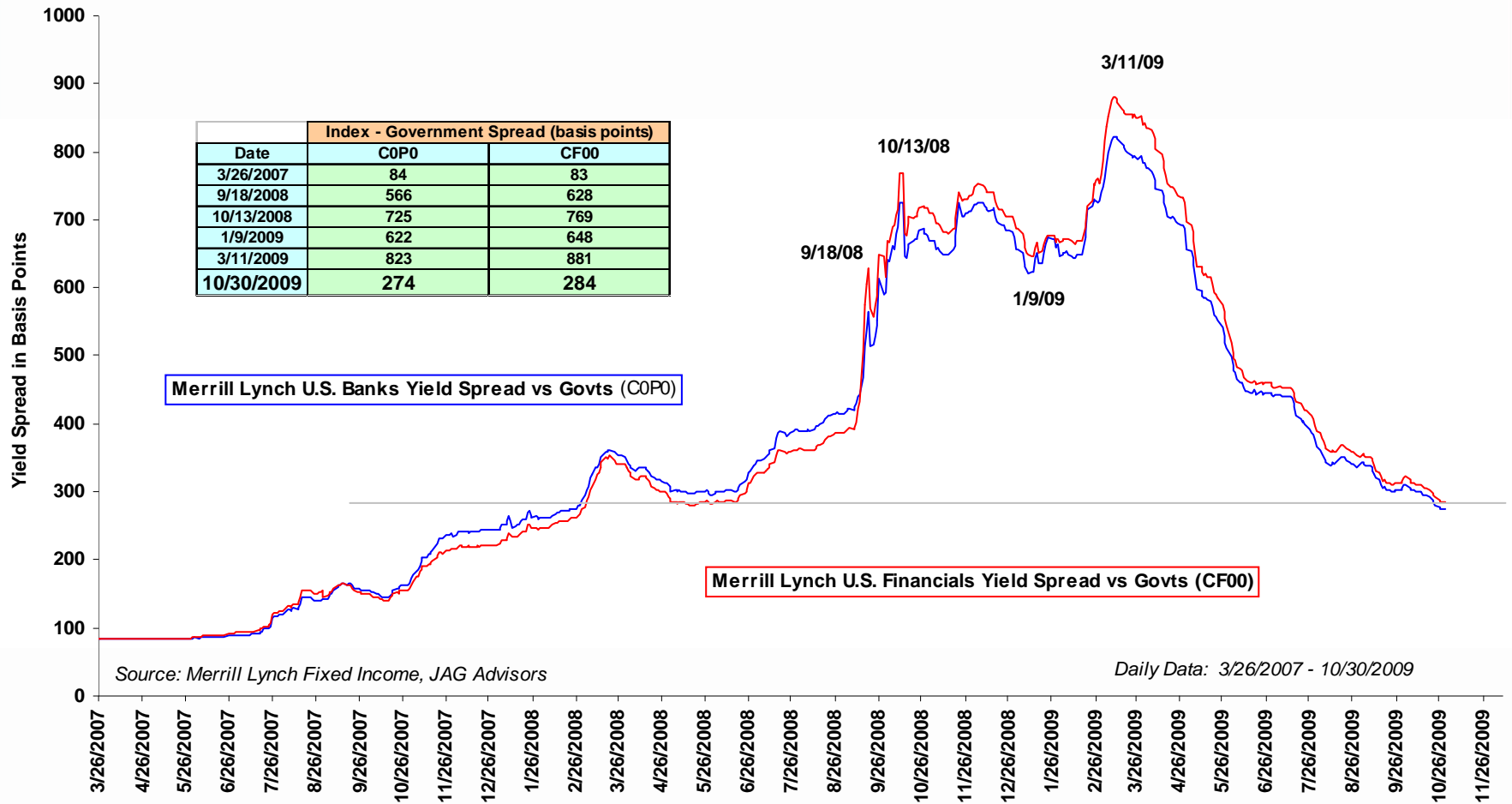
# Risk Premiums Rose Sharply Post LTCM



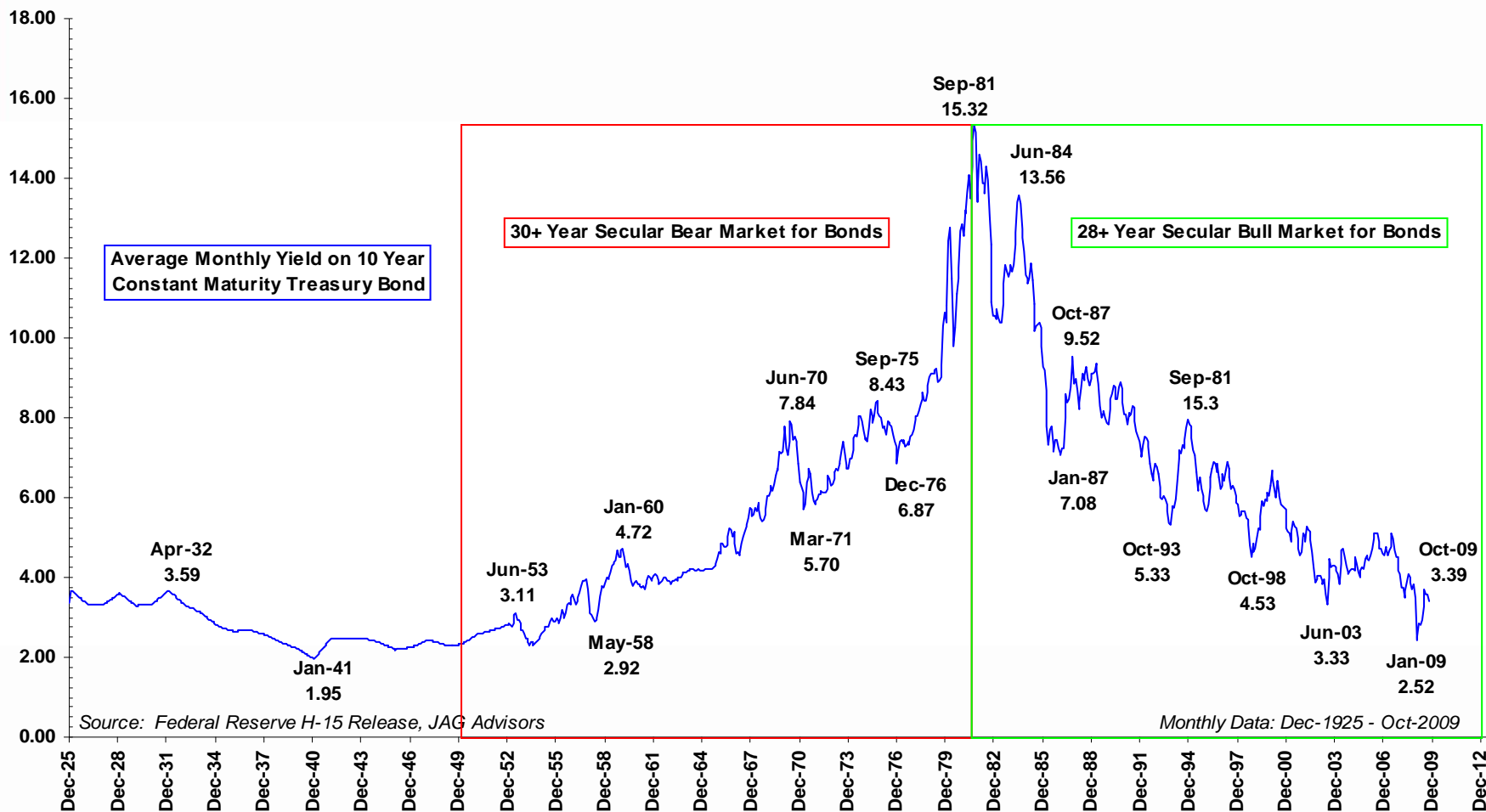
# BAA/10-Year Treasury Yields Since 1926



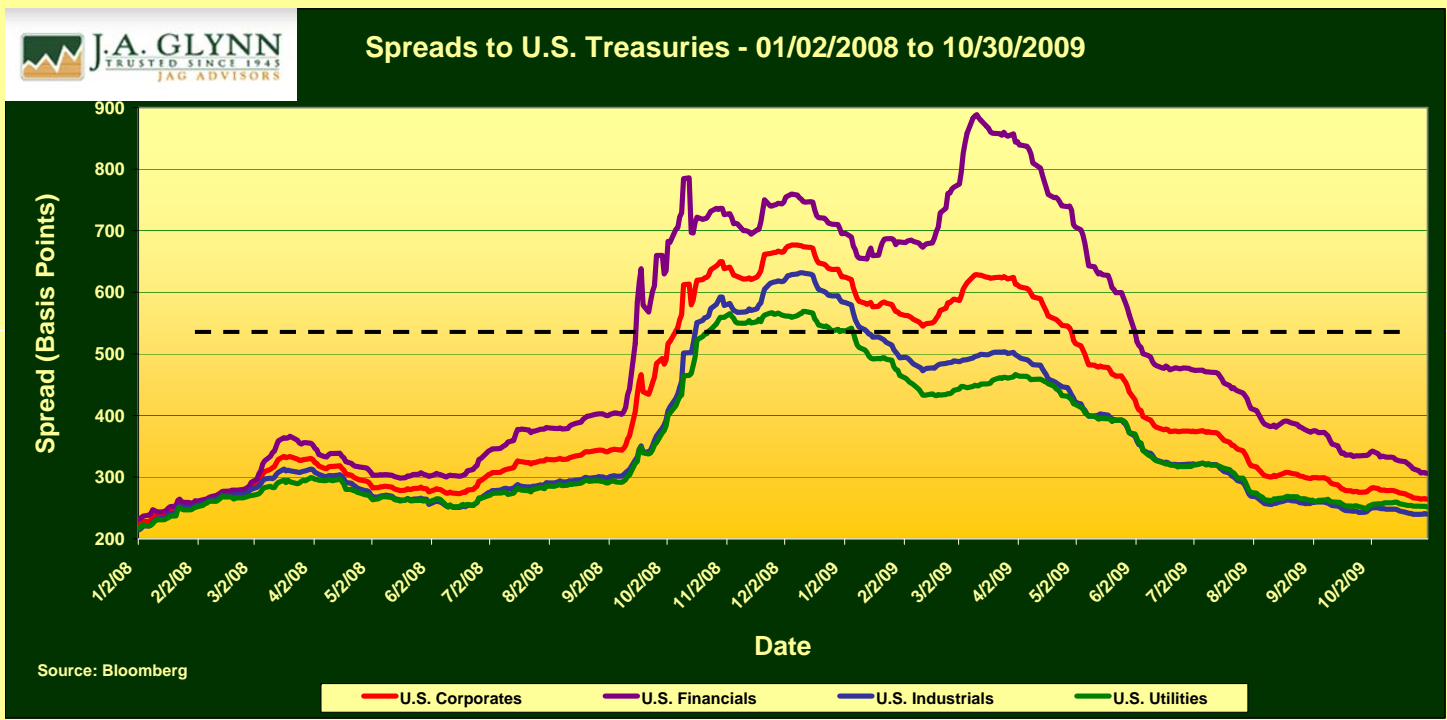
# Financial Debt Spreads Continue to Tighten



# How Low Can it Go?: 10-Year Treasury Yields



# Investment Grade Bond Spreads: 1/08 thru 10/09

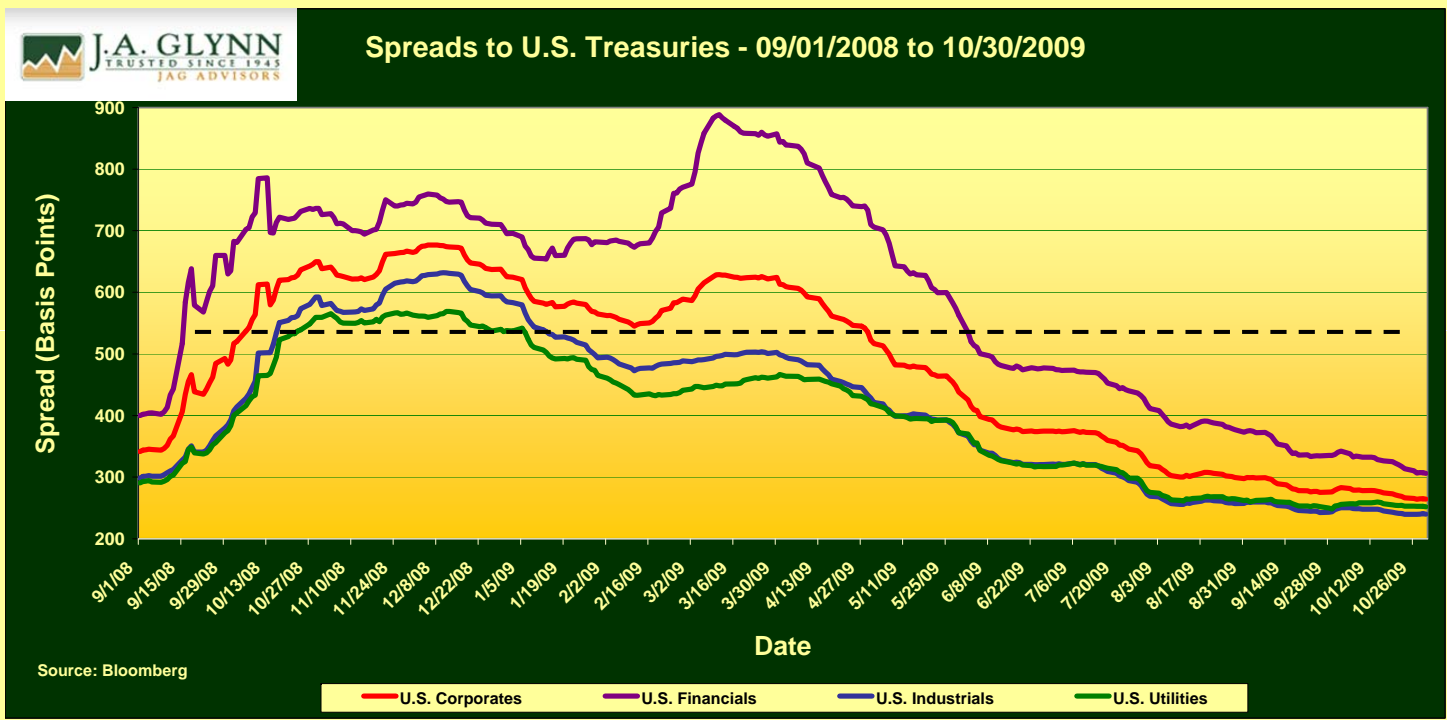


Metrics Within Selected Period:

Item	High Spread/Date Attained	Low Spread/Date Attained	Average Spread	Last Spread
Corporates:	676.8 (12/05/2008)	222.2 (01/02/2008)	412.0	264.3
Financials:	888.3 (03/11/2009)	231.8 (01/02/2008)	494.5	306.2
Industrials:	631.8 (12/10/2008)	214.4 (01/02/2008)	363.8	240.0
Utilities:	569.0 (12/11/2008)	217.2 (01/02/2008)	351.3	251.8



# Investment Grade Bond Spreads: 9/08 thru 10/09

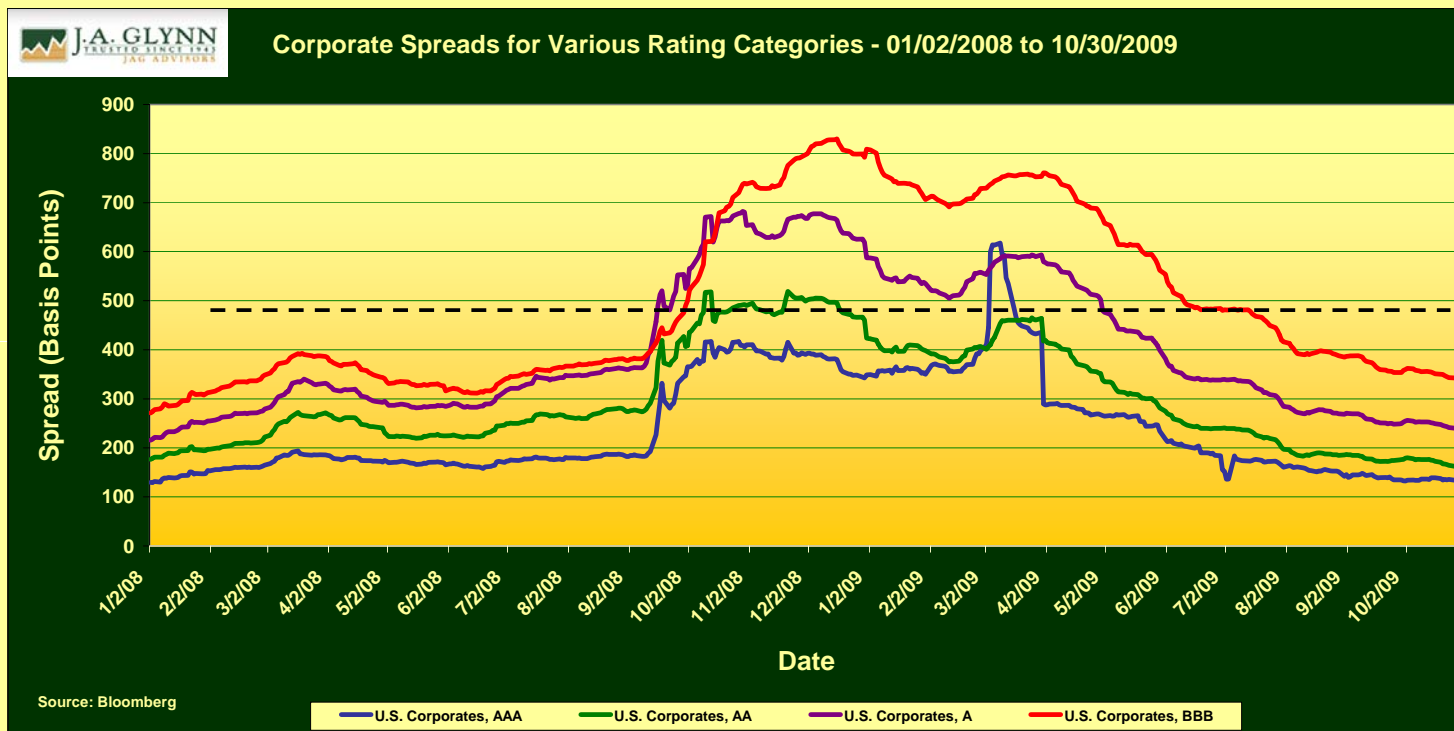


Metrics Within Selected Period:

Item	High Spread/Date Attained	Low Spread/Date Attained	Average Spread	Last Spread
Corporates:	676.8 (12/05/2008)	264.2 (10/27/2009)	479.4	264.3
Financials:	888.3 (03/11/2009)	306.2 (10/30/2009)	594.1	306.2
Industrials:	631.8 (12/10/2008)	239.4 (10/23/2009)	414.6	240.0
Utilities:	569.0 (12/11/2008)	248.2 (09/29/2009)	397.8	251.8

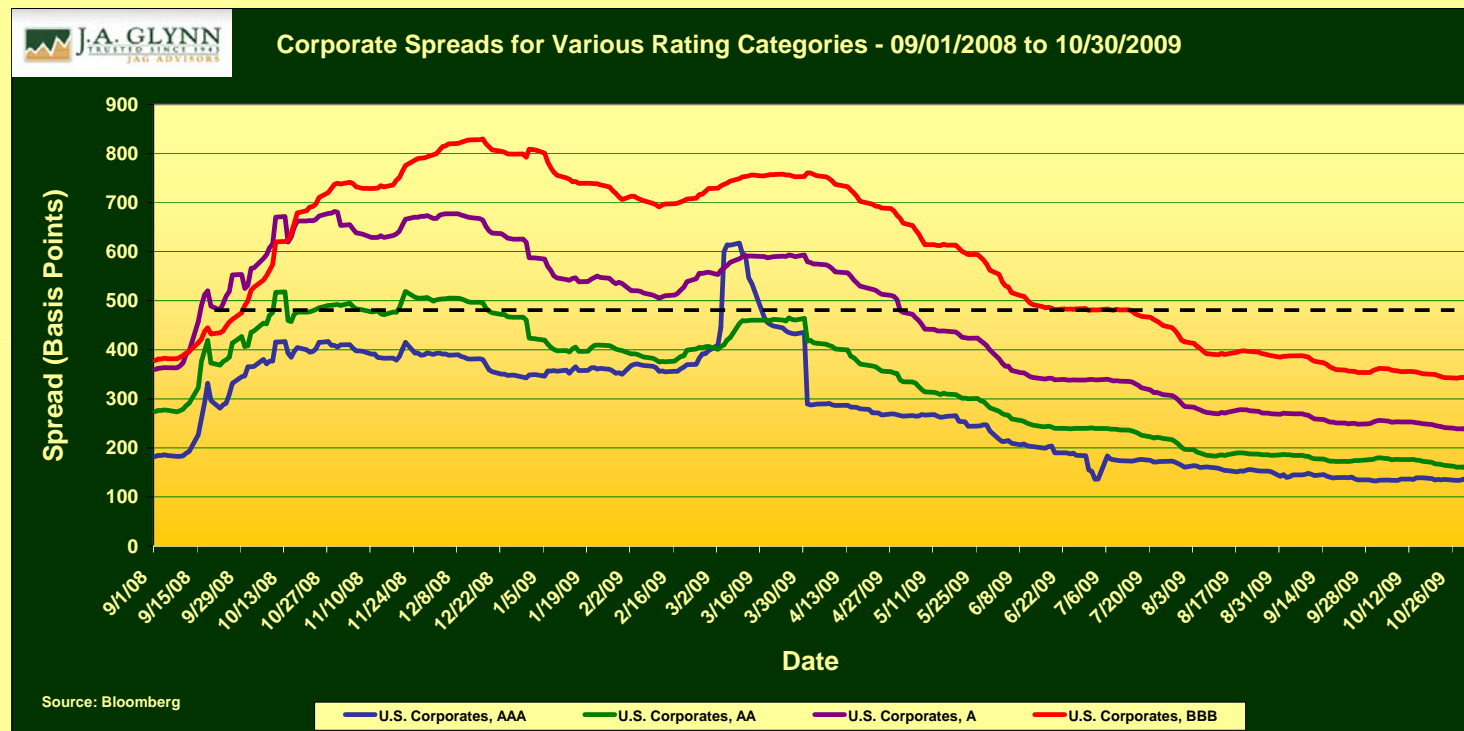


# Spreads by Rating: 1/08 thru 10/09



Metrics Within Selected Period:				
Item	High Spread/Date Attained	Low Spread/Date Attained	Average Spread	Last Spread
AAA	617.5 (03/09/2009)	129.5 (01/02/2008)	241.0	137.3
AA	519.0 (11/21/2008)	159.9 (10/30/2009)	300.6	159.9
A	681.8 (10/29/2008)	215.7 (01/02/2008)	402.5	237.7
BBB	829.8 (12/16/2008)	271.1 (01/02/2008)	497.6	343.5

# Spreads by Rating: 9/08 thru 10/09



Metrics Within Selected Period:				
Item	High Spread/Date Attained	Low Spread/Date Attained	Average Spread	Last Spread
AAA	617.5 (03/09/2009)	132.5 (10/01/2009)	282.1	137.3
AA	519.0 (11/21/2008)	159.9 (10/30/2009)	337.4	159.9
A	681.8 (10/29/2008)	237.7 (10/30/2009)	461.3	237.7
BBB	829.8 (12/16/2008)	342.1 (10/27/2009)	586.4	343.5

## JAG Model Statistics vs. Benchmarks – 10/31/09

Summary Statistics	JAG Corporate Fixed Income Model	Barclays Intermediate Corporate Index	JAG ECFI Model	Barclays Intermediate Government/Credit Index
Weighted Average Modified Duration	4.2 Yrs.	4.5 Yrs.	4.0 Yrs.	3.9 Yrs.
Weighted Average Maturity	5.3 Yrs.	5.4 Yrs.	4.8 Yrs.	4.5 Yrs.
Weighted Average Credit Rating	Baa1	A3	Baa1	Aa2
Weighted Average Yield to Worst	5.1%	4.3%	4.6%	2.6%

# Conclusion

- Economic backdrop continues to improve – but uncertainty remains
  - Unemployment/Underemployment a continued sore spot
  - What will “new normal” GDP growth be?
  - Residential real estate bottoming but still in poor condition
  - Commercial real estate potentially the next source of stress
  - Fed is in between a rock and a hard place vis-à-vis inflation
    - Tighten too early, at risk of instigating a double-dip in economy
    - Tighten too late, at risk of igniting inflation
    - We think inflation and higher rates are a bigger risk than a double-dip in 2010-2011
- Fixed Income markets
  - We think nominal Treasuries are unattractive after multi-decade bull run
  - Odds favor higher Treasury yields over next several years
  - Corporate securities continue to look attractive
- JAG strategies: Enhanced Core Fixed Income, Corporate Fixed Income
  - Both strategies are positioned strategically to “win” in two ways:
    - Continued normalization of yield spreads
    - Low/intermediate duration
    - Laddered approach to reduce impact of yield curve shifts
  - Strategic, *not* tactical tools
    - Should be considered as multi-year portfolio components
    - Tactical plays can be better executed with ETF's of open-ended funds
  - Overriding goals
    - Produce yield premium via a value-centric approach
    - Opportunistic focus on BBB/A ratings
    - Maintain a diversified approach to avoid over-exposure to potential problems
    - Maintain a buy-and-hold bias to minimize trading friction

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