

Centerpoint Advisors Fixed Income Third Quarter 2011 Overview

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Overview

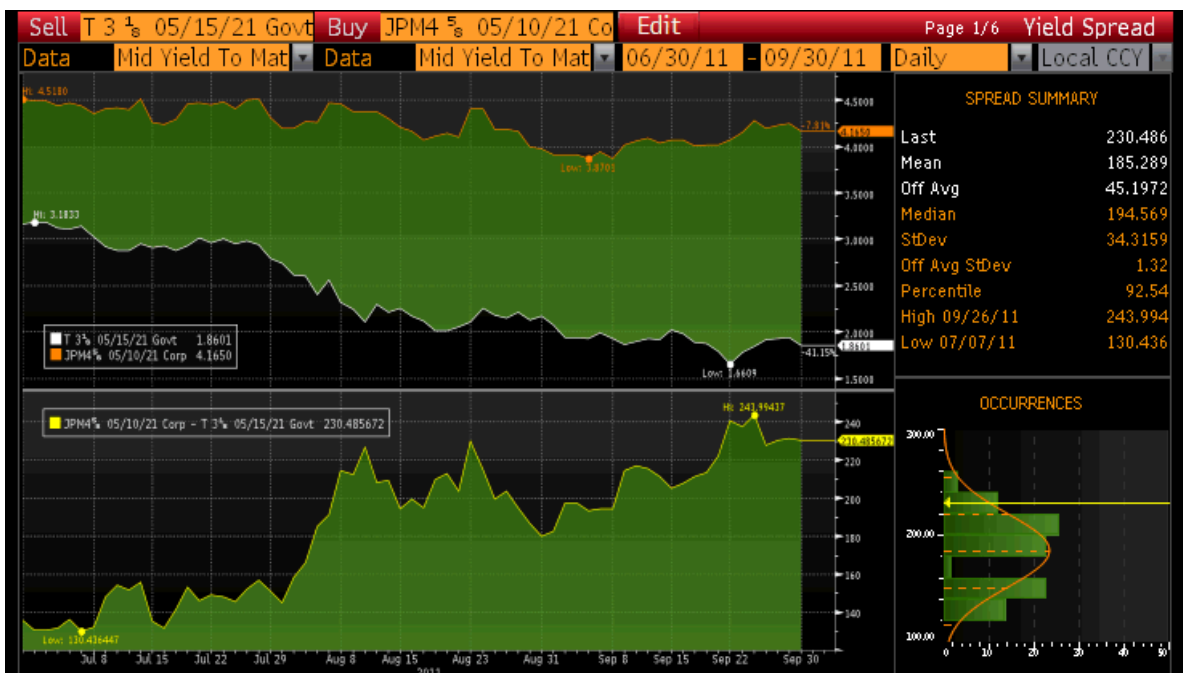
The third quarter seemed to have an unprecedented amount of market-moving activity. During the quarter, negotiations on raising the debt ceiling and efforts by some politicians to obtain spending cuts tied to their vote became the primary focus for investors. While an increase in the debt ceiling was ultimately passed, the lack of political cohesiveness and defined cuts in spending resulted in Standard and Poor's downgrading the sovereign debt rating of the United States to AA+ from its long held AAA. While the drama of a debt ceiling vote and credit downgrade is behind us (for now), our underlying weak economy and the fiscal issues facing Europe (and their banks) are once again in focus.

General Interest Rates

As the second quarter came to an end, it became apparent that the "strength" of the US economy was in question. The 10-year Treasury yield had declined during most of the second quarter and we entered the third quarter at a yield of 3.16%. After several weak economic releases, the possibility of a double dip recession began to be discussed and the flight to treasuries continued, pushing the yield on the 10-year Treasury to 1.86% by quarter end. As investors purchased treasuries, they reduced their holdings in "risk" assets such as equities and corporate debt... the result was a drop in stock prices and a widening in corporate credit spreads. In the investment grade corporate sector, spreads widened across all sectors with the greatest widening occurring in bank and finance debt. As an example, JPMorgan 4.625% due 5/10/21 entered the quarter trading at a spread of approximately 136 basis points over treasuries and closed the quarter at approximately 230 basis points. (Exhibit 1) Overall credit, both in investment grade and high yield, underperformed during the quarter (Table 1).

Exhibit 1: Yield Spreads

JPMorgan 4.625% due 5/10/21 vs. U.S. Treasury 3.125% due 5/15/21



Source: Bloomberg as of 10/24/2011.

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Table 1: Selected Bank of America / Merrill Lynch (BAML) Indices

BAML Indices	Index Returns (%)			
	July	August	September	Q3 2011
BofA ML 1-5 Year U.S. Investment Grade Corporate Index	0.916	(0.486)	(0.988)	(0.558)
BofA ML 1-5 Year U.S. Municipal Securities Index	0.498	0.581	(0.119)	0.960
BofA ML U.S. High Yield (Cash Pay) Index	1.224	(3.907)	(3.526)	(6.209)

All yields sourced from Bloomberg.

Tax Exempt Market

While municipal bonds did not rally in lock step with Treasuries, their yields did drop across most of the curve (higher prices). Performance of the overall sector was driven heavily by price appreciation on the long end and coupon payments on the shorter end (1-5 year sector). Remember that the overall performance of a debt instrument is a combination of its price appreciation (or depreciation) and its stated coupon rate. The rally in price was helpful for investors who were exposed to both the taxable and tax exempt sectors. As has been the case in the past, a lack of supply (and lack of negative news) has allowed the sector to perform relatively well during periods when other sectors have underperformed. That said, municipals are still cheap (on a relative basis) and are back to levels well in excess of 100% of Treasuries across the entire curve (Table 2).

Table 2: Selected Key Rates

Generic State General Obligation Municipal Bonds AAA Rated	Yield to Maturity as of		As % of US Government Treasuries	
	9/30/2011	6/30/2011	9/30/2011	6/30/2011
2yr General Obligation due 2013	0.35%	0.43%	123.59%	86.90%
5yr General Obligation due 2016	1.10%	1.27%	114.65%	72.40%
10yr General Obligation due 2021	2.22%	2.67%	110.66%	80.99%

All yields sourced from Bloomberg.

Our Portfolios

As we mentioned in our previous note we feel that a rate increase (either by the market or the Federal Reserve) is now farther down the road than was previously believed. That said, we continue to look to extend maturities as opportunities arise. On the taxable side, we feel that the recent underperformance in corporate debt presents somewhat of a buying opportunity in the right names. We would look to add to the sector, keeping in mind that various factors (European debt issues, weak economic data, etc) could make the sector volatile. As we have indicated in the past, we feel that corporate balance sheets are in significantly better condition than they were back in late 2008, and should be able to weather a continued weak economy for a while. On the tax exempt side, we feel that high quality municipal debt at levels well in excess of treasuries (on an absolute basis) offers value and look to continue to invest in the sector as supply becomes available.



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