

Centerpoint Advisors Fixed Income Fourth Quarter 2011 Overview

John E. Wolfsberg
 Director of Fixed Income

Overview

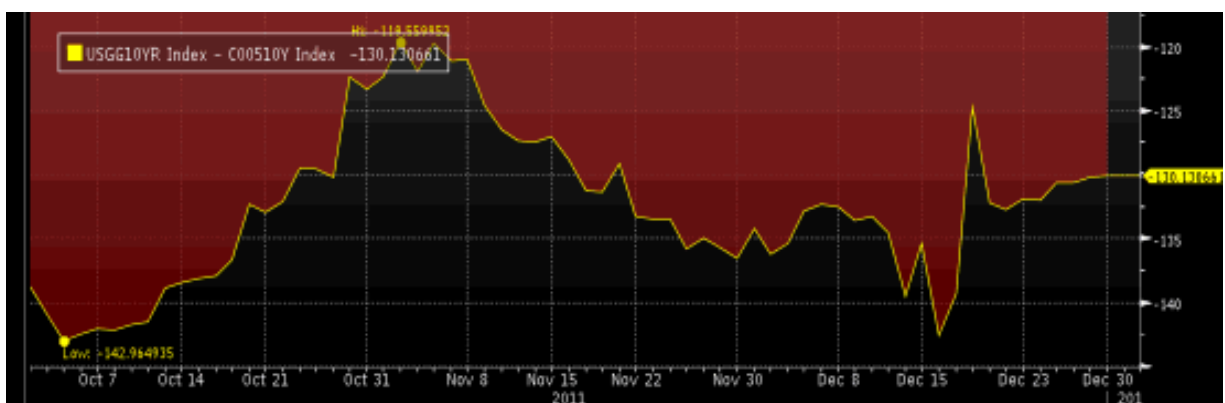
The fourth quarter had less interest rate volatility than had been present in the previous quarters. While the month of October saw yields in the 10 year Treasury rise slightly, prices for the benchmark moved higher as fiscal issues overseas continued to create demand for the safety of US Treasuries. As a result, the 10 year Treasury traded throughout the rest of the quarter in a relatively tight range, around the 2% level. While the domestic picture seems to be relatively quiet for the moment, the economic turmoil in Europe continues to make daily headlines. Just recently, S&P took action on several major countries within the European Union, downgrading the sovereign rating of these nations one to two notches. For now, it appears as though the markets are taking the downgrade in stride (in fact France, who was stripped of their AAA rating, saw their borrowing costs drop at their country's first bill sale after the downgrade). Is it possible that much of the bad news is already factored into the market?

General Interest Rates

As previously noted, general interest rates (Treasuries) remained relatively stable during the quarter. A slight improvement in the October payroll report caused treasury rates to move higher during the month, dropping again though as the month came to a close. Corporate bond spreads also reacted to the improved payroll report. As we noted in our previous newsletter, corporate bond spreads (both investment grade and high yield) had widened during the 3rd quarter as concern over Europe caused investors to reduce risk (risk off). However, the wide spreads in corporate bonds, coming into the quarter (Exhibit, 1) attracted investors during October and a significant tightening in credit spreads ensued (risk on). As the month of November began, the issues in Europe took center stage (again) and investors sold corporate debt once again (risk off). The risk on/off trade continues and is being impacted by the general economic climate as well as the fiscal issues in Europe. However, the volatility and the extent of the moves is being exacerbated by the supply/demand relationship. Demand continues to remain relatively high, driven by Exchange Traded Funds (ETFs) and Mutual Funds. The supply situation has changed dramatically over the last several months as primary dealer inventories have been reduced almost by half, as dealers limit the capital they commit to their fixed income trading businesses (Exhibit 2). As the quarter came to an end, corporate spreads began to tighten again as investors looked to get fully invested by year end (risk on).

Exhibit 1: Yield Spreads

US Corporate 10 Year Index (Investment Grade) vs. US Treasury 10 Year Index



Source: Bloomberg as of 1/18/2012.

Centerpoint Advisors Fixed Income Fourth Quarter 2011 Overview

Exhibit 2: Primary Dealer Corporate Inventory January – December 2011



Tax Exempt Market

Municipal bonds continued their positive price performance during the quarter. Overall, municipal bonds turned in a very solid performance for 2011 with the Bank America/Merrill Lynch 3-7 year US General Obligation Municipal Securities Index returning 6.795%. However, as has been the case in previous quarters, municipal bonds have not rallied lock step with Treasuries and as of quarter end, offered yields across most of the curve in excess of 100% of corresponding treasuries (Exhibit 3). While absolute levels continue to be low, relative value would suggest that municipals are cheap to treasuries (historically, municipal bonds trade at 80-85% of Treasury yields).

Exhibit 3: Selected Key Rates

Generic State General Obligation Municipal Bonds AAA Rated	Yield to Maturity as of		As % of US Government Treasuries	
	12/30/2011	9/30/2011	12/30/2011	9/30/2011
2yr General Obligation due 2013	0.41%	0.35%	148.71%	123.59%
5yr General Obligation due 2016	0.94%	1.10%	110.16%	114.65%
10yr General Obligation due 2021	2.08%	2.22%	106.30%	110.66%

All yields sourced from Bloomberg.



Centerpoint Advisors Fixed Income Fourth Quarter 2011 Overview

Our Portfolios

As previously discussed, we expect Treasury rates to remain low for a while longer. In fact, since I began drafting this newsletter the Federal Reserve Open Market Committee (FOMC) indicated in its January meeting release that it would anticipate interest rates to remain low until at least late 2014 (extended from their previous timeframe of mid 2013). While we have seen corporate spreads tighten (both in investment grade and high yield), we continue to feel the sector is attractive for two reasons: first, spreads continue to be wide on a historical basis – almost half the yield on an investment grade bond is attributable to the spread component, and second, we feel primary dealers will continue to keep corporate exposure (inventories) low as they commit capital to higher margin businesses. On the tax exempt side, while yields on a relative value basis are cheap, we recognize that absolute levels are quite low. That said, we are being selective and would look to add to positions as supply comes into the market or opportunities arise. In both the taxable and tax exempt markets we look to add exposure in the 5-7 year part of the curve (for those portfolios having good short term liquidity), as we feel (and they have stated) that the Federal Reserve may be on hold for another 2-3 years. Keep in mind that while the FOMC may wish to “talk down” interest rates, it is the market itself (investors) that control levels. Should the economy begin to pick up steam and inflation expectations begin to rise, investors in all fixed income securities will quickly look to re-evaluate yields and the FOMC timeframe could be cut short.

Disclosure: Centerpoint Advisors, LLC is an investment advisor registered with the Securities and Exchange Commission. Centerpoint Advisors, LLC provides fundamental investment management services to investors. The views expressed contain certain forward-looking statements. Centerpoint Advisors believe these forward-looking statements to be reasonable, although they are forecasts and actual results may be meaningfully different. Actual events may cause adjustments in portfolio management strategies from those currently expected to be employed. This material represents an assessment of the market at a particular time and is not a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any security in particular. The performance data quoted represents past performance. Past performance does not guarantee future results. Current performance may be lower or higher than the performance quoted. By investing in high yield bonds you may be subjected to greater price volatility based on fluctuations in issuer and credit quality. When investing in bonds, you are subject, but not limited to, the interest rate, inflation and credit risks associated with the underlying bonds. Bonds may be worth less than original cost upon redemption or maturity. All security yields and prices sourced from Bloomberg. All graphs sourced from Bloomberg. The Bloomberg Generic US Corporate 10 Year Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market with a remaining term to final maturity less than 10 years. The US Treasury 10 Year Index tracks the performance of US Treasury securities with a remaining term to final maturity less than 10 years. The BofA Merrill Lynch 3-7 Year US General Obligation Municipal Securities Index is a subset of The BofA Merrill Lynch US Municipal Securities Index including all securities that are general obligations of states or local authorities with a remaining term to final maturity greater than or equal to 3 years and less than 7 years. The BofA Merrill Lynch US Municipal Securities Index tracks the performance of US dollar denominated investment grade tax-exempt debt publicly issued by US states and territories, and their political subdivisions, in the US domestic market. Securities offered through National Securities Corporation, member FINRA/SIPC. Accounts are carried by National Financial Services LLC, Member NYSE/SIPC, a Fidelity Investments ® company. Centerpoint Advisors, LLC and National Securities Corporation are not affiliated.

