

Centerpoint Advisors Fixed Income First Quarter 2010 Overview



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Overview

The first quarter picked up where the fourth quarter fixed income markets left off. Strong demand by bond mutual funds and institutions continued to keep rates low in both taxable and tax exempt bonds. During the quarter, some of the headlines that caught the attention of bond investors included the fiscal crisis facing Greece, passage of the Health Care Reform Bill and associated tax increases, and the continued fiscal problems facing various states just to name a few.

Taxable Market

During the quarter the 10yr treasury traded in the range of 3.60% to 3.88% (subsequent to quarter end 10yr yields traded up to 4% but have since come back down to the 3.80% area as of this writing). The March treasury auction of 2 and 5yr notes attracted less demand than anticipated, pushing yields across the entire treasury curve higher. It was not until we received economic data indicating that economy was recovering at a very slow pace did rates come back down. I have said before in this newsletter that my concern with treasury yields is not from the risk of inflation (due to improved economic activity), but as a result of the significant mountain of debt that will need be issued to finance the national deficit. Corporate spreads improved slightly during the quarter with spreads in 10yr industrial paper tightening several basis points. Yields, in general, were relatively unchanged from the beginning of the quarter to the end (See Diagram 1).

Municipal Bonds

The municipal market was somewhat uneventful for most of the quarter. Tax exempt yields continued to grind lower and at one point during the quarter approached 56% of treasury yields in the 5 year sector and 78% in the 10 year sector (historically this relationship has been around 80% and 85%, respectively... see Diagrams 2a and 2b). Late in March the market witnessed several events that impacted yields. The enactment of the Health Care Bill which included a tax on unearned income (not municipal bond tax-exempt interest) was probably the most bullish event for municipals (i.e. raising prices / lowering yields). However, during the end of the quarter, flows into municipal bond funds fell dramatically (according to Lipper/AMG Data statistics). Total flows were just under \$300 million for the week ended March 24th versus a 4 week moving average of over just \$600 million. As a result, yields in intermediate municipals reversed course and moved higher by approximately 30 bps during the final two weeks of the quarter. One question investors should be asking themselves after reading this is why the weak inflows? Is it that fund investors are finally

Diagram 1: Select Bond Yields

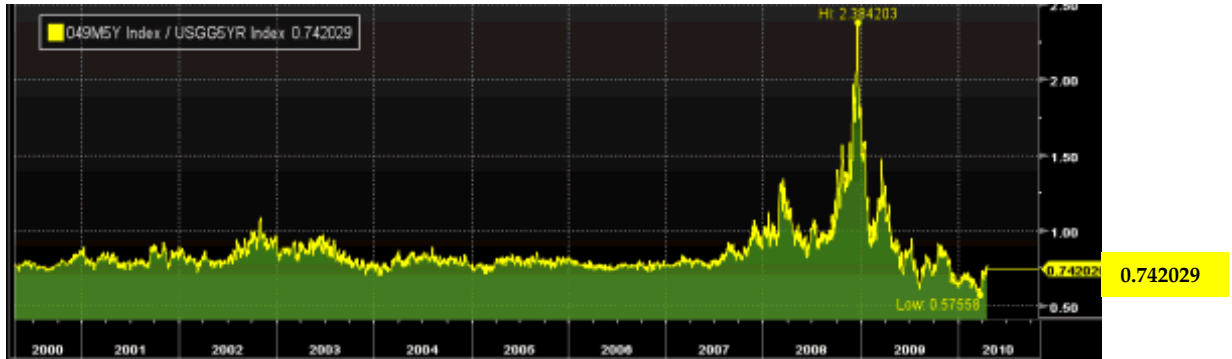
Selected Treasury Yields		Yield to Maturity as of		
		3/31/2010	12/31/2009	
2yr - 1% coupon due 12/31/11		0.87%	1.14%	
5yr - 2.625% coupon due 12/31/14		2.45%	2.68%	
10yr - 3.375% coupon due 11/15/19		3.81%	3.84%	
30yr - 4.375% coupon due 11/15/39		4.71%	4.64%	
Generic State General Obligation Municipal Bonds (AAA Rated)	Yield to Maturity as of		AAA Municipal as % of Current US Gov't Securities	
	3/31/2010	12/31/2009	3/31/2010	12/31/2009
2yr General Obligation	0.73%	0.62%	72.08%	53.84%
5yr General Obligation	1.80%	1.66%	70.48%	61.29%
10yr General Obligation	3.27%	3.26%	85.05%	83.09%
Money Market Fund Yields		7-Day Current Yield		
		4/16/2010	1/12/2010	
Fidelity Cash Reserves Fund (FDRXX)		0.01%	0.08%	

Treasury and Municipal yields as of March 31, 2010 and December 31, 2009, respectively, and sourced from Bloomberg. Money Market yields as of April 16, 2010 and January 12, 2010, respectively, and sourced from Bloomberg.

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**Diagram 2a: Generic 5-Year AAA General Obligation Municipal Bond
as a Percentage of U.S. Generic 5-Year Treasury Bond**



Source: Bloomberg

Date Range 4/19/2000 – 4/19/2010

**Diagram 2b: Generic 10-Year AAA General Obligation Municipal Bond
as a Percentage of U.S. Generic 10-Year Treasury Bond**



Source: Bloomberg

Date Range 4/19/2000 – 4/19/2010

Municipal Bonds Continued...

starting to get concerned about the fiscal issues facing states and local municipalities? We have mentioned in the past the significant budget deficits facing many states... add this to the large unfunded public pension and health benefit liabilities and one can see why investors would pause before buying municipal bonds at close to 50% of treasuries.

Our Portfolios

On the taxable side, we continue to focus on high quality corporate bonds and agency securities on the short to intermediate part of the curve. As noted above we did witness a brief spike in 10yr yields to 4% subsequent to quarter end. We think the market is looking for an excuse to push through the 4% barrier – a few good economic releases could be all that is needed. Municipal bonds have become more attractive as a result of the back-up in yields. While we are cautious about the fiscal issues facing states, the recent rise in rates and the exclusion of tax



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Our Portfolios Continued...

exempt income from new taxes to be levied from the Health Care Reform Bill make municipal bonds more attractive. That said, our purchases continue to be limited to higher quality names in the short to intermediate part of the curve where we are able to pick up yields that are 80% or higher of treasuries.

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