CHANDLER ASSET MANAGEMENT

September 2011

BOND MARKET REVIEW

A MONTHLY REVIEW OF FIXED INCOME MARKETS

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Since 1988, Chandler Asset Management has specialized in the management of fixed income portfolios. Chandler's mission is to provide fully customizable, client-centered portfolio management that preserves principal, manages risk and generates income in our clients' portfolios.

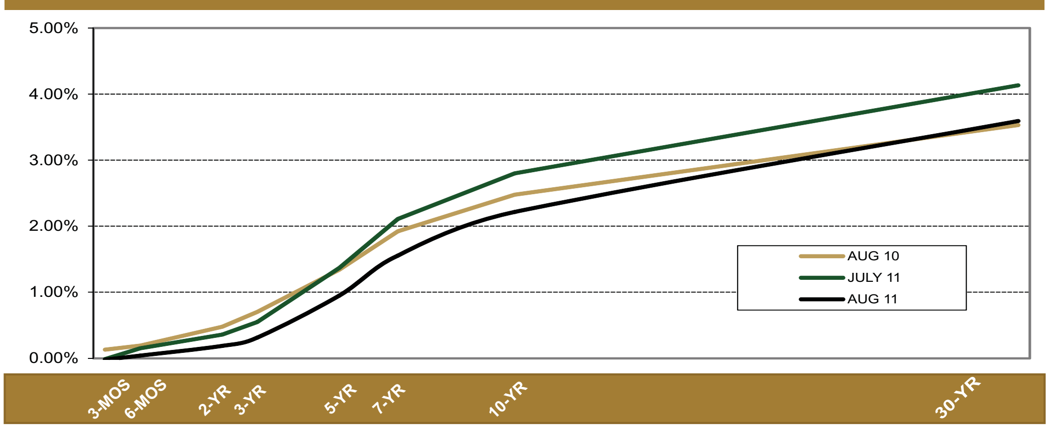
Market Summary

Treasury yields moved sharply lower in August in response to concerns about a slowing global economy, equity market turmoil, and sovereign debt issues in the euro zone. Events in Europe have been the primary market mover over the past month, and policy makers there have so far been unable to contain the spreading turmoil. Market participants will be watching closely for a resolution to European sovereign debt issues in the weeks and months ahead.

Recent U.S. economic data has been consistent with a very sluggish pace of growth, but has not been indicative of a recessionary environment. The employment report was disappointing, as the economy did not add any jobs in August. On the plus side, retail sales and consumer credit improved, and leading economic indicators were positive. Some economists have begun to differentiate between “soft” data collected through surveys and “hard” data reflecting actual economic activity. While the former has been quite poor, “hard” data has improved slightly and has given some economists hope that the economy can avoid recession and perhaps even accelerate slightly.

The Federal Reserve kept the federal funds rate at a target range of 0.00% to 0.25% at its August 9 meeting, but deviated from previous policy by specifically stating that it expected to maintain exceptionally easy monetary conditions "at least through mid-2013." In its assessment of current economic conditions, the Fed noted, "economic growth so far this year has been considerably slower than the committee had expected." The Fed also "discussed the range of policy tools available to promote a stronger economic recovery." The next regularly scheduled FOMC meeting is September 20.

TREASURY YIELDS MUCH LOWER



YIELDS	8/31/11	7/31/11	CHANGE
3 Month	(0.02)	(0.01)	(0.01)
2 Year	0.19	0.36	(0.17)
3 Year	0.31	0.55	(0.24)
5 Year	0.95	1.37	(0.42)
7 Year	1.55	2.11	(0.56)
10 Year	2.22	2.80	(0.58)
30 Year	3.59	4.13	(0.54)

Economic Roundup

Consumer Prices

In July, the CPI showed that consumer prices increased 3.6% on a year-over-year basis. The year-over-year Core CPI (CPI less food and energy) increased at a 1.8% rate. Although some producer prices have begun to increase, prices on consumer goods are not expected to rise sharply in the months ahead. The Federal Reserve has noted that it is monitoring commodity price increases, but does not believe that they will flow through to sharply higher consumer prices

Retail Sales

In July, Retail Sales rose 8.5% on a year-over-year basis. Consumer spending has rebounded from the depths of the recession and recent activity has been moderate; however, activity is still far short of the heights of the previous economic expansion as a weak job market and high energy prices restrain consumer spending.

Labor Markets

The August employment report showed that the economy added zero jobs and the previous month's total was revised lower. The unemployment rate remained at 9.1%. This report was disappointing and confirmed that the employment situation in the country remains poor. Even though the economic recovery is two years old, the pace of recovery in the labor market is extremely weak by historical standards and is one of the primary reasons why the recovery has been tepid.

Housing Starts

Single-family housing starts declined 4.9% in July to 425,000, compared to 447,000 in June. The housing market seems to have stabilized following several years of sharp declines, but activity and prices have not yet shown substantial improvement.

Credit Spreads Mixed

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top-rated commercial paper	0.32	0.10	0.22
2-year AA corporate note	0.58	0.35	0.23
5-year AA corporate note	0.82	0.54	0.28
5-year Agency note	0.45	0.40	0.05

Source: Bloomberg

Data as of 8/31/2011

Mixed Economic Data

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(53.1) $Bln JUN 11	(50.8) $Bln MAY 11	(46.9) $Bln JUN 10
GDP	1.0% JUN 11	0.4% MAR 11	3.8% JUN 10
Unemployment Rate	9.1% AUG 11	9.1% JUL 11	9.6% AUG 10
Prime Rate	3.25% AUG 11	3.25% JUL 11	3.25% AUG 10
CRB Index	342.57 AUG 11	342.08 JUL 11	264.19 AUG 10
Oil (West Texas Int.)	$88.81 AUG 11	$95.70 JUL 11	$71.92 AUG 10
Consumer Price Index (y/o/y)	3.6% JUL 11	3.6% JUN 11	1.2% JUL 10
Producer Price Index (y/o/y)	7.2% JUL 11	7.0% JUN 11	4.1% JUL 10
Dollar / EURO	1.44 AUG 11	1.44 JUL 11	1.27 AUG 10

Source: Bloomberg

Corporate Bonds: A Primer

While Corporate bonds are sometimes perceived as being risky, the fact of the matter is that investment grade (those rated BBB and above) Corporate bonds can enhance portfolio returns without a dramatic increase in risk. Corporate bonds carry higher yields than government bonds, which when combined with their diversification benefits and a rigorous security selection process, can result in an attractive combination of risk/reward for a portfolio.

Historically, Corporate bonds have carried higher yields than government or agency bonds. This difference between corporate and government bond yields, known as the spread, fluctuates over time, but it is always present. The reason that Corporate bonds have these higher yields is to compensate for the credit and default risk that they carry. Even though Corporate bonds are more risky than government bonds, prudent investors can avoid a large portion of this risk while capturing potentially higher returns.

INVESTMENT GRADE

AAA = Carry the smallest amount of investment risk; the obligor's capacity to meet its financial commitment on the obligation is *extremely strong*.
AA = Judged to be of high quality by all standards; differs from highest rated obligations in only a small degree; the obligor's capacity to meet its financial commitment on the obligation is *very strong*.
A = Somewhat more susceptible to adverse effects of changes in circumstances than higher rated obligations; capacity to meet financial commitment is still *strong*.
BBB = Security appears adequate for the present but certain protective elements may be lacking; exhibits *adequate* protection parameters.

SPECULATIVE GRADE

BB and Below = Contain speculative elements; their future can not be considered as well-assured.

There are two types of risk found in a portfolio: Systematic risk refers to the risk that is inherent throughout the market and thus cannot be avoided; Unsystematic risks are those that are found in an individual company or investment. A properly managed portfolio can reduce unsystematic risk by holding a diversified group of Corporate bonds.

Risk can be reduced further by employing a rigorous security selection process. A starting point for the security selection process is looking at issuers' securities ratings. Moody's, S&P, and Fitch are the largest ratings agencies in the United States. These agencies rate securities on a scale, with ratings above "BBB" indicating investment grade securities and ratings below this indicating high yield or speculative securities.

Moody's	S&P	Fitch
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Ba1	BB+	BB+
Ba2	BB	BB
Ba3	BB-	BB-

Importantly, at this point, we do not feel that recent events warrant meaningful changes to investment portfolios. As always, we will continue to closely monitor developments and if circumstances change we will be in further contact with you. In the meantime, please do not hesitate to contact us if you have any questions regarding ongoing events.

While adding a small measure of risk to a portfolio, Corporate bonds also enhance portfolio returns over time. For example, during the ten year period ending 6/30/2011, the annualized return of a 1-5 year government bond portfolio was 4.29%. While this is an attractive return, it was exceeded by that of a 1-5 year portfolio that held 20% of its assets in Corporate bonds. The combined government and corporate portfolio posted an annualized return of 4.45% over the same period, while outperforming the government only portfolio in seven of the ten years. During the ten-year period ending 6/30/2011, the portfolio that held Corporate bonds would have produced excess returns that translated into an additional $2.2 million in growth for a $100 million portfolio.

While past performance is no guarantee of future success, the data does seem to indicate that holding a well-diversified group of Corporate bonds, as part of a portfolio is an attractive long-term proposition. The higher historical returns of such a portfolio, combined with a comprehensive credit review process, can combine to produce a portfolio with an attractive risk/reward profile.

Value on 6/30/2011 of $100 million invested 6/30/2001

	6/30/2011	Annualized Return
1-5 Year Government Benchmark	$152,268,169	4.29%
1-5 Yr Corp A-AAA/Govt Benchmark	$154,498,327	4.45%

-Brian Perry, CFA
Portfolio Manager & Investment Strategist

RISKS AND OTHER IMPORTANT CONSIDERATIONS
This report is provided for general information purposes only and should not be construed as specific legal, tax, or financial planning advice. All opinions and views constitute judgments or relevant information as of the date of writing and such information may become outdated or superseded at any time without notice. This report is not intended to constitute an offer, solicitation, recommendation or advice regarding any securities or investment strategy. This information should not be regarded by recipients as a substitute for the exercise of their own judgment.

Fixed income investments are subject to interest, credit, and market risk. Interest rate risk: the value of fixed income investments will decline as interest rates rise. Credit risk: the possibility that the borrower may not be able to repay interest and principal. Low rated bonds generally have to pay higher interest rates to attract investors willing to take on greater risk. Market risk: the bond market in general could decline due to economic conditions, especially during periods of rising interest rates.