CHANDLER ASSET MANAGEMENT

April 2012

BOND MARKET REVIEW

A MONTHLY REVIEW OF FIXED INCOME MARKETS

WHAT'S INSIDE

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

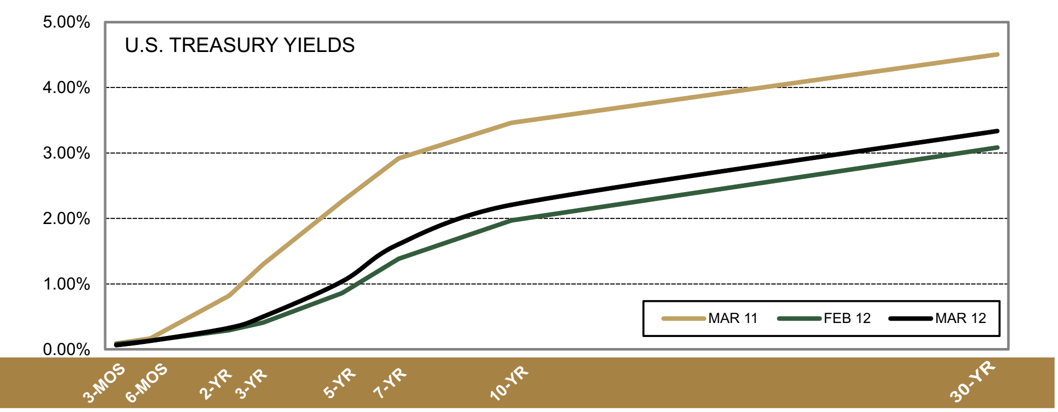
Treasury rates moved higher in March, driven by ongoing improvement in domestic economic data and reduced market expectation of further asset purchases from the Federal Reserve. In addition, rising oil prices, coupled with improving domestic economic data, has raised investor concerns about accelerating inflation, driving bond yields higher. However, Operation Twist (which expires at the end of June) continues to put downward pressure on longer-term interest rates.

We believe domestic economic data remains indicative of a slow growth environment. The labor market continues to improve and the manufacturing sector remains healthy. In March, the unemployment rate fell to 8.2% from 8.3% in February, and non-farm payrolls grew by an average of approximately 212,000 per month throughout the first quarter. Consumer confidence also continues to show strength, despite the near 20% rise in gas prices since the beginning of the year. Though political and economic turmoil in Europe continues to create volatility in global financial markets, European leaders have made progress in addressing the regions debt crisis.

In March, the Federal Reserve announced it would retain the policy rate range of 0.0-0.25%. The Fed provided a generally upbeat assessment of the economy, and held off on announcing any new forms of quantitative easing, despite market speculation to the contrary. There was no change to the Fed's assurance the fed funds rate will remain exceptionally low through late 2014. Recent increases in gas prices were acknowledged, but the Fed expects the impact on overall inflation will be temporary. The Fed noted that while strains on global financial markets have eased, they continue to pose a significant downside risk to the economic outlook. The next FOMC meeting is scheduled for April 24th and 25th.

TREASURY YIELDS ROSE IN MARCH

Source: Bloomberg



Treasury yields moved higher in March, driven by ongoing improvement in domestic economic data.

TREASURY YIELDS	3/31/12	2/29/12	CHANGE
3 Month	0.07	0.08	(0.01)
2 Year	0.33	0.29	0.04
3 Year	0.50	0.41	0.09
5 Year	1.04	0.86	0.18
7 Year	1.61	1.38	0.23
10 Year	2.21	1.97	0.24
30 Year	3.34	3.09	0.25

Source: Bloomberg

Economic Roundup

Consumer Prices

In February, the CPI showed consumer prices increased 2.9% on a year-over-year basis. The year-over-year Core CPI (CPI less food and energy) increased at a 2.2% rate. Overall, price increases remained subdued. However, concerns recently developed about rising oil prices and the negative impact higher gas prices at the pump could have on consumer spending.

Retail Sales

In February, Retail Sales rose 6.5% on a year-over-year basis. Consumer spending rebounded from the depths of the recession and recent activity was moderate; however, high unemployment continues to restrain consumer spending. High gas prices may also pose a headwind to future consumer spending.

Labor Markets

The March employment report showed the economy added 120,000 jobs. The report was moderately disappointing, even though the unemployment rate declined 0.1% to 8.2%. Although the unemployment rate remains elevated, current economic data suggests the labor market is improving at a slow but steady pace.

Housing Starts

Single-family housing starts declined 9.9% in February to 457,000, compared to 507,000 in January. However, there was strength in multi-family starts which rose 21.1% for the month. The housing market remains under pressure, but seems to have stabilized following several years of sharp declines. Some housing data has recently surprised to the upside.

Credit Spreads Tighter

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top-rated commercial paper	0.15	0.19	(0.04)
2-year AA corporate note	0.24	0.23	0.01
5-year AA corporate note	0.36	0.48	(0.12)
5-year Agency note	0.26	0.28	(0.02)

Source: Bloomberg

Data as of 3/31/12

Economic Data Modestly Improving

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(52.6) $Bln JAN 12	(50.4) $Bln DEC 11	(47.5) $Bln JAN 11
GDP	3.0% DEC 11	1.8% SEP 11	2.3% DEC 10
Unemployment Rate	8.3% FEB 12	8.3% JAN 12	9.0% FEB 11
Prime Rate	3.25% MAR 12	3.25% FEB 12	3.25% MAR 11
CRB Index	308.46 MAR 12	322.43 FEB 12	359.43 MAR 11
Oil (West Texas Int.)	$103.02 MAR 12	$107.07 FEB 12	$106.72 MAR 11
Consumer Price Index (y/o/y)	2.9% FEB 12	2.9% JAN 12	2.1% FEB 11
Producer Price Index (y/o/y)	3.3% FEB 12	4.1% JAN 12	5.4% FEB 11
Dollar / EURO	1.33 MAR 12	1.33 FEB 12	1.42 MAR 11

Source: Bloomberg

The Federal Reserve Balance Sheet and Implications for Fixed Income Investors

The recent rise in Treasury market yields has some investors concerned the United States may be on the precipice of an inflation problem. The non-farm payrolls report has averaged an increase of 212,000 jobs over the past three months and the unemployment rate has ticked down to 8.2% versus 8.8% in March 2011, indicative of a strengthening economy. Similar to the first quarter of 2011, where the S&P 500 equity index returned 5.42%, equity markets have posted impressive positive results year to date in 2012. The direction of interest rates is also similar, Five year Treasury notes increased by 20 basis points (2.02% to 2.22%) during the first quarter of 2011 versus increasing by 21 basis points (0.83% to 1.04%) in the first quarter of 2012.

At Chandler we feel many of the issues that led to market volatility in 2011 remain mostly unresolved as we look forward into 2012. We consider the largest, but by no means only, lingering concern for market participants remains Europe sovereign debt risk and the impact on US markets. The European Central Bank (ECB) recently engaged in a form of quantitative easing via two Long Term Refinancing Operations (LTROs) to inject liquidity into the European banking system. The three year term on the loans offered by the ECB limits the time frame for the ECB's balance sheet to expand. European sovereign bond yields recovered after implementation of the LTROs, and no additional such operations are expected.. In our view, the ECB continually does just enough to calm markets in the short term, but fails to provide a definitive long term solution. Finding the right balance of policies to promote fiscal austerity and simultaneously stimulate economic growth, so that even more austerity is not required down the road, will prove challenging for the Eurozone.

> It is not only the actual level of interest rates or the size of the Fed's balance sheet that influence prices in the capital markets - the rate of change in each of these metrics is also an important element.

The recovery in the United States remains lackluster by historical standards. The soft recovery has contributed to the unemployment rate remaining elevated and less revenue for Federal, State, and Local governments. The inability of political leaders at the Federal level to find common ground on long-term deficit reduction is poised to impact markets in 2013. The rules put in place prior to the formation of the bipartisan “Super Committee” in 2011 require significant spending cuts across the Federal Budget in 2013, including expiration of the Bush tax cuts. Consensus estimates average a negative 2.5% - 3.5% impact to GDP in 2013. We question whether the markets are strong enough to absorb a contraction in government spending coinciding with a less accommodative Federal Reserve. When taking into account the totality of the economic backdrop, including the impact of a slowing Europe and the coming fiscal contraction in the United States, fears of accelerating inflation are not supported in our view.

The Federal Reserve has become a more transparent institution under Chairman Bernanke's leadership. The committee remains steadfast in its official communication regarding its commitment to accommodative monetary policy, driven primarily by low rates of resource utilization and a subdued outlook for inflation over an intermediate time horizon. Since the onset of the financial crisis the Fed's balance sheet expanded dramatically, increasing in size by over 3x. The composition of the underlying assets on the balance sheet has also changed, with the Mortgage Backed Securities component now being larger than the size of the overall balance sheet pre crisis. However we are now well past the most aggressive expansion of the Federal Reserve's balance sheet via the first two rounds of Quantitative Easing (QE). Operation Twist (OT), set to expire in June 2012, is the latest iteration of unorthodox Fed policy. OT has not altered the size of the Fed's balance sheet, just the maturity of the underlying holdings of the Treasury component. It is not only the actual level of interest rates or the size of the Fed's balance sheet that influence prices in the capital markets - the rate of change in each of these metrics is also an important element. Post expiration of OT in June 2012, the potential risk is the rate of change will turn negative as the Fed's balance sheet will start to contract and the average maturity of the underlying assets will shorten, potentially putting upward pressure on interest rates.

We believe any move materially higher in interest rates will be self-correcting. Real yields (interest earned less inflation) are so low, investors feel compelled to consider a more material allocation to higher risk assets for the potential to earn a real rate of return commensurate with historical norms. If equity markets and other higher risk assets deteriorate in a higher rate environment, we believe consumer balance sheets will deteriorate, and the already weak recovery will take a few steps backward.

Arguably one of the most significant legacies of Chairman Bernanke is his willingness to be creative with unorthodox tools available to the Federal Reserve to promote full employment and economic growth. Policymakers need to continue this trend of being creative with the Federal Reserve's balance sheet to achieve its dual mandate of maximum employment and stable prices. If you can accept the hypothesis that historically low rates are a foregone conclusion over an intermediate time horizon, the Fed should avoid disrupting the recovery by lessening its support of the higher risk assets via low fixed income rates. A significant move lower in equity market valuations could potentially derail some of the positive aspects of the recovery experienced to date. We welcome the day when monetary policy can normalize. Normalization in our view is consistent with a Fed Funds rate of approximately 2.0%, Ten year yields of approximately 4.0%, and a contracting Fed balance sheet; however that day is not yet upon us.

William Dennehy II
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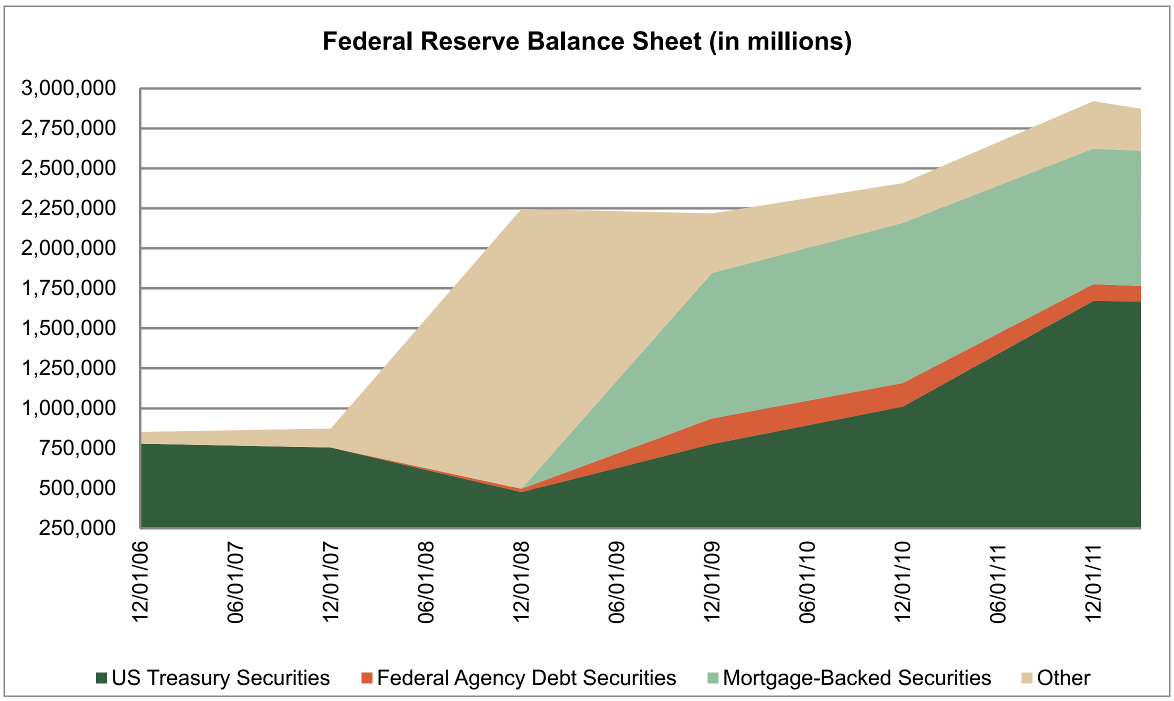

Source: Federal Reserve of the United States