CHANDLER ASSET MANAGEMENT

December 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

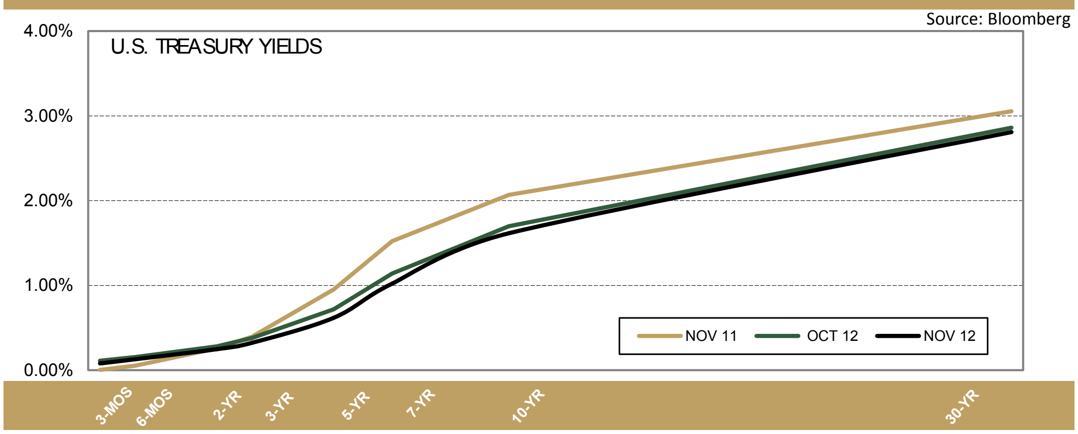
The treasury yield curve declined slightly in November. Yields have remained within a tight range at low levels, as uncertainties about the domestic and global economy persist. Rates also continue to be influenced by the Federal Reserve's accommodative monetary policy, continued purchase of securities onto their balance sheet, and their desire to keep interest rates contained. In the U.S., concerns about the fiscal cliff have escalated as budget negotiations continue. Meanwhile, Europe's economy remains troubled. Though the region has made strides toward containing its sovereign debt crisis, including measures to reduce Greece's debt burden, concerns about political turmoil in Italy have recently begun to weigh on markets.

Domestic economic growth remains sub-par. Improvement in the labor market has been modest at best, while trends in the manufacturing sector have been sluggish and reports on the consumer have been mixed. Payroll growth was better than expected but modest in November, up 146,000, and the unemployment rate remained elevated at 7.7%. Housing data, on the other hand, has been favorable and recent reports suggest that the housing market continues to firm.

The Federal Open Market Committee left policy rates unchanged at its December meeting at a target range of 0%-0.25%, and announced a plan to implement additional quantitative easing. As market participants expected, the Fed said it will purchase longer-term Treasuries at a pace of $45 billion per month for an unspecified period of time, after "Operation Twist" (the current bond-buying program of roughly the same size) expires at the end of December. The Fed also said that it will continue to purchase additional agency mortgage-backed securities at a pace of $40 billion per month, for an open-ended period of time. The Fed's guidance for policy rates is now linked to economic markers rather than a timing target. Specifically, the Fed said that an exceptionally low fed funds rate will be appropriate as long as unemployment remains above 6.5% or until inflation looks set to exceed 2.5%. The Committee had previously indicated that the fed funds rate would remain at an exceptionally low level through at least mid-2015. Overall, the Federal Reserve continues to pursue aggressive stimulus programs, and is forecasting slightly faster economic growth next year and a gradual decline in unemployment.

TREASURY YIELD CURVE DECLINED SLIGHTLY IN NOVEMBER

Source: Bloomberg



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TREASURY YIELDS	11/30/2012	10/31/12	CHANGE
3 Month	0.08	0.11	(0.03)
2 Year	0.25	0.28	(0.03)
3 Year	0.32	0.38	(0.06)
5 Year	0.62	0.72	(0.10)
7 Year	1.02	1.14	(0.12)
10 Year	1.62	1.69	(0.07)
30 Year	2.81	2.86	(0.05)

Source: Bloomberg

Economic Roundup

Consumer Prices

In October, overall CPI inflation rose to 2.2% on a year-over-year basis from 2.0% in September. The year-over-year Core CPI (CPI less food and energy) remained steady at 2.0% in October. The core inflation rate is in line with the Fed's inflation target of 2.0%.

Retail Sales

In October, Retail Sales rose 3.8% on a year-over-year basis. On a month-over-month basis, Retail Sales fell 0.3% in September, lower than the consensus forecast of a 0.1% decline. Hurricane Sandy likely had a negative impact on the October sales report. Overall, recent consumer spending trends have been modest, but elevated unemployment levels continue to put pressure on the consumer.

Labor Markets

The November employment report showed that payrolls increased by 146,000 (well above the consensus estimate of 80,000), following a gain of 138,000 in October. Private payrolls advanced 147,000 while government jobs declined by 1,000. Service providing industries showed notable job gains but jobs in the goods-producing sector fell by 22,000. The unemployment rate declined to 7.7% in November from 7.9% in October, but the decline was largely driven by a contraction in the labor force. Overall, the jobs report headline was better than expected but the details of the report were mixed and improvement in the labor market continues to be modest at best. The employment report continues to reflect an overall slow pace of growth in the domestic economy.

Housing Starts

Single-family housing starts were roughly flat in October at 594,000 vs. 595,000 in September (the highest level since August 2008). Recent data suggests that the housing market continues to firm.

Credit Spreads Widened

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top-rated commercial paper	0.11	0.08	0.03
2-year A corporate note	0.57	0.49	0.08
5-year A corporate note	0.89	0.79	0.10
5-year Agency note	0.22	0.25	(0.03)

Source: Bloomberg Data as of 11/30/12

Economic Data Continues to Indicate Slow Growth

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(41.5) $Bln SEP 12	(43.8) $Bln AUG 12	(44.5) $Bln SEP 11
GDP	2.7% SEP 12	1.3% JUN 12	1.3% SEP 11
Unemployment Rate	7.7% NOV 12	7.9% OCT 12	8.7% NOV 11
Prime Rate	3.25% NOV 12	3.25% OCT 12	3.25% NOV 11
CRB Index	298.98 NOV 12	295.84 OCT 12	313.82 NOV 11
Oil (West Texas Int.)	$88.91 NOV 12	$86.24 OCT 12	$100.36 NOV 11
Consumer Price Index (y/o/y)	2.2% OCT 12	2.0% SEP 12	3.5% OCT 11
Producer Price Index (y/o/y)	2.3% OCT 12	2.1% SEP 12	5.8% OCT 11
Dollar/EURO	1.30 NOV 12	1.30 OCT 12	1.34 NOV 11

Source: Bloomberg

Season's Greetings

And

Best Wishes for the New Year

Ned Marty Kay Ted

Kara

Bill Mia Don

Andy WEB

Yoni Gary

Jaspen Jeannie

Parth. Kian

Shelly Don

Mike

Jeff

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