CHANDLER ASSET MANAGEMENT

February 2016

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.

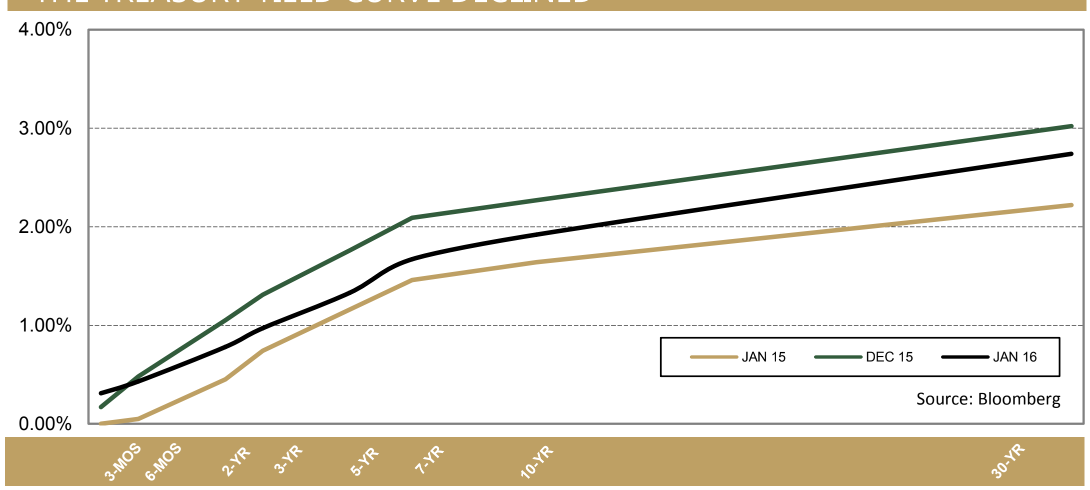
Market Summary

As expected, at the January meeting, the Federal Open Market Committee (FOMC) left the fed funds rate unchanged at a range of 0.25%-0.50%. The Committee noted that labor market conditions continued to improve since the December meeting, even as economic growth slowed. Meanwhile, market-based measures of inflation compensation declined further. Inflation is expected to remain low, partially due to the continued decline in energy prices. The Committee continued to indicate that the pace of future rate hikes will be gradual. Although the FOMC didn't take the possibility of a March fed funds rate hike off the table, we believe policy rates are likely to remain on hold for at least the next few months in light of growing concerns about global economic growth and in the absence of inflationary pressures.

Though concerns about commodity prices and emerging market economies are heightened, and financial markets have been volatile, domestic economic data remains relatively good. Trends in the labor market remain favorable, and consumer confidence is solid. Housing trends are also healthy. However, the manufacturing sector remains weak. The ISM manufacturing index has been below 50.0 since October, suggesting that the manufacturing sector is contracting. Nevertheless, payrolls have increased by an average of 231,000 per month over the past three months, and the unemployment rate has declined to 4.9%, which should provide a tailwind for economic growth this year. Consumer spending continues to be the primary driver of domestic economic growth and a strong labor market, modest wage growth, and low gas prices should benefit consumers. Market participants are forecasting moderate GDP growth of 2.0-2.5% in 2016. Based on the ongoing relative strength of the US dollar, which is a headwind for economic growth, we believe 2016 GDP growth is likely to be at the lower end of the 2.0%-2.5% range.

In January, rates across most of the Treasury yield curve declined. The yield on 2-year Treasury securities declined 27 basis points, while the yield on 10-year Treasury securities declined 35 basis points. We believe this contraction is attributed to disappointing global economic data, continued weakness in commodity markets, and market participants' expectation that the pace of future rate hikes is likely to be slower than previously anticipated. At the end of December, the implied probability of a rate hike in March 2016, according to fed funds futures, was more than 50%. By the end of January, the probability of a March rate hike declined to 14%. According to fed funds futures, most market participants currently expect the FOMC to remain on hold until at least the end of this year. This is in sharp contrast to the FOMC's "dot plot" which suggests that the Federal Reserve could raise the fed funds rate 3 or 4 times before year-end. We believe the "dot plot", which depicts the FOMC's assessment of appropriate monetary policy, will likely contract over the medium term.

THE TREASURY YIELD CURVE DECLINED



We believe this decline in interest rates is attributed to disappointing global economic data, continued weakness in commodity markets, and market participants' expectation that the next fed funds rate hike may be delayed longer than previously expected.

TREASURY YIELDS	1/31/2016	12/31/2015	CHANGE
3 Month	0.31	0.17	0.14
2 Year	0.78	1.05	(0.27)
3 Year	0.97	1.31	(0.34)
5 Year	1.33	1.76	(0.43)
7 Year	1.67	2.09	(0.42)
10 Year	1.92	2.27	(0.35)
30 Year	2.74	3.02	(0.28)

Source: Bloomberg

Economic Roundup

Consumer Prices

In December, the Consumer Price Index (CPI) rose 0.7% on a year-over-year basis, up from 0.5% in November. Year-over-year comparisons have become easier, given the precipitous decline in energy prices at the end of 2014. Meanwhile, Core CPI (CPI less food and energy) was up 2.1% in December on a year-over-year basis, vs. up 2.0% in November. The Personal Consumption Expenditures (PCE) price index was up 0.6% on a year-over-year basis in December, up from 0.4% in November. Core PCE (excluding food and energy) was unchanged in December, up 1.4% on a year-over-year basis. Overall, inflationary pressures remain benign.

Retail Sales

On a year-over-year basis, retail sales were up 2.2% in December, versus growth of 1.6% in November. On a month-over-month basis, retail sales fell 0.1% in December. Excluding autos and gas, the figure was flat, slightly weaker than the consensus forecast. Overall, consumer spending trends have been modest.

Labor Market

Payrolls were weaker than expected in January but the unemployment rate continued to decline, the participation rate increased, and wages ticked higher. Nonfarm payrolls rose by 151,000 in January, below the consensus forecast of 190,000. November and December payrolls were revised for a net decrease of just 2,000. The unemployment rate edged down in January to 4.9% from 5.0%. The participation rate inched up to 62.7% from 62.6%. Wages rose 0.5%, exceeding expectations for a 0.3% increase. A broader measure of unemployment called the U-6, which includes those whom are marginally attached to the labor force and employed part time for economic reasons, was unchanged at 9.9%. Over the past three months, payrolls have increased by an average of 231,000 per month, compared to the trailing six-month average of 215,000. Even though the headline payroll figure for January was disappointing, labor market trends remain favorable.

Housing Starts

Total housing starts declined 2.5% on a month-over-month basis in December, missing expectations. Single-family housing starts fell 3.3% while multi-family starts fell 1.0%. Housing starts tend to be volatile on a month-to-month basis, but the underlying trend remains favorable with total housing starts up 6.4% on a year-over-year basis.

Credit Spreads Widened in January

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change (%)
3-month top-rated commercial paper	0.16	0.26	(0.10)
2-year A corporate note	0.67	0.55	0.12
5-year A corporate note	1.03	0.85	0.18
5-year Agency note	0.21	0.18	0.03

Source: Bloomberg *Data as of 1/31/2016*

Economic Data Remains Indicative of Slow Growth

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(43.4) $Bln DEC 15	(42.2) $Bln NOV 15	(45.5) $Bln DEC 14
GDP	0.7% DEC 15	2.0% SEP 15	2.1% DEC 14
Unemployment Rate	4.9% JAN 16	5.0% DEC 15	5.7% JAN 15
Prime Rate	3.5% JAN 16	3.5% DEC 15	3.25% JAN 15
CRB Index	166.75 JAN 16	176.14 DEC 15	218.84 JAN 15
Oil (West Texas Int.)	$33.62 JAN 16	$37.04 DEC 15	$48.24 JAN 15
Consumer Price Index (y/o/y)	0.7% DEC 15	0.5% NOV 15	0.8% DEC 14
Producer Price Index (y/o/y)	(2.7%) DEC 15	(3.2%) NOV 15	(0.6)% DEC 14
Dollar/EURO	1.08 JAN 16	1.09 DEC 15	1.13 JAN 15

Source: Bloomberg