CHANDLER ASSET MANAGEMENT

March 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.

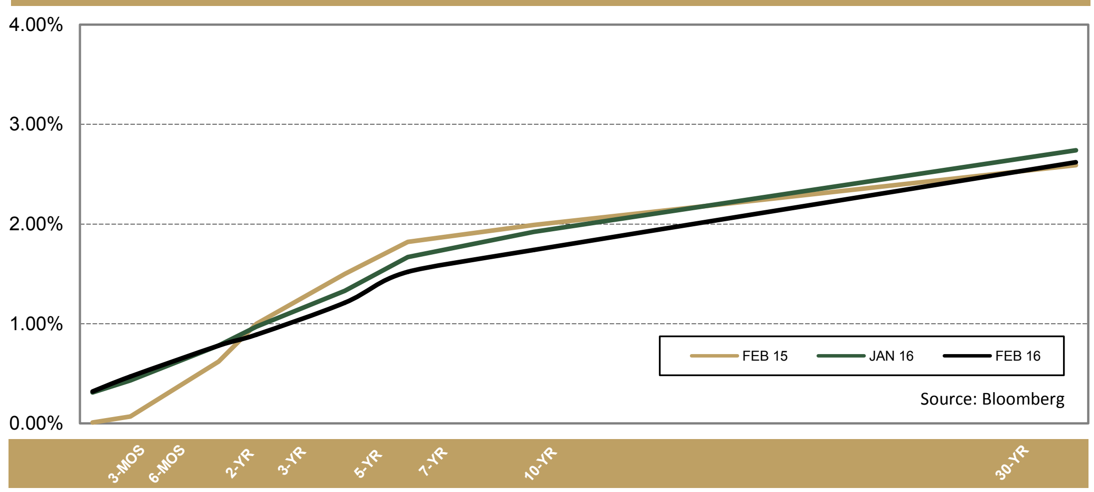
Market Summary

We believe the Federal Reserve (Fed) is likely to keep monetary policy on hold this month, but the implied probability (based on fed funds futures) of another fed funds rate hike at mid-year has increased. Currently, the implied probability of a rate hike around mid-year is approximately 45% and the implied probability of a rate hike in September is greater than 50%. However, the implied probability of a rate hike at the upcoming March 15-16 Federal Open Market Committee (FOMC) meeting remains very low, and we do not believe the FOMC is likely to shock the market. In February, Fed Chair Yellen testified before Congress and provided the Fed's semi-annual Monetary Policy Report. Yellen noted the economy made further progress toward maximum employment and inflation is expected to rise toward the Fed's 2% objective over the medium-term. Nevertheless, we expect the Fed to keep policy rates on hold until at least this summer in light of global economic concerns. Chair Yellen conceded the economic outlook is uncertain and foreign economic developments pose risks to the domestic economy.

Economic data is mixed. Labor market conditions continue to improve and consumer confidence is strong. Housing trends remain healthy. However, the manufacturing sector continues to be weak. The ISM manufacturing index has been below 50.0 since October, suggesting the manufacturing sector is contracting. Nevertheless, payrolls have increased by an average of 228,000 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. Fourth quarter 2015 GDP grew at an annualized pace of 1.0%, following growth of 2.0% in the third quarter. Market participants are currently forecasting GDP growth of about 2.0% in the first quarter of 2016, and 2.0-2.5% for the full year 2016. Based on recent economic data, we believe 2016 GDP growth is likely to be at the lower end of the 2.0%-2.5% range.

The Treasury yield curve has flattened, which is consistent with historical Fed tightening cycles. The FOMC's "dot plot", which depicts the FOMC's assessment of appropriate monetary policy, suggests that the Federal Reserve could raise the fed funds rate three or four times before year-end. We believe the "dot plot" will likely move closer to market expectations over the medium term. Although fed funds futures prices currently indicate investors expect the Fed to raise rates once this year, we believe two 25 basis point rate hikes before year-end is a distinct possibility. Ongoing uncertainty about monetary policy and how the Fed communicates its economic projections will likely continue to fuel financial market volatility.

THE TREASURY YIELD FLATTENED



In February, the Treasury yield curve flattened, with the yield on 2-year Treasuries unchanged and the yield on 10-year Treasuries down nearly 20 basis points.

TREASURY YIELDS	2/29/2016	1/31/2016	CHANGE
3 Month	0.32	0.31	0.01
2 Year	0.78	0.78	0.00
3 Year	0.89	0.97	(0.08)
5 Year	1.21	1.33	(0.12)
7 Year	1.52	1.67	(0.15)
10 Year	1.74	1.92	(0.18)
30 Year	2.62	2.74	(0.12)

Source: Bloomberg

Economic Roundup

Consumer Prices

Although energy and commodity prices remain weak, overall inflation pressures are beginning to creep higher. The Consumer Price Index (CPI) rose 1.4% year-over-year in January, up from 0.7% in December. Year-over-year comparisons have become easier, given the precipitous decline in energy prices at the end of 2014. Core CPI (CPI less food and energy) rose 2.2% in January, up from 2.1% in December. The Personal Consumption Expenditures (PCE) index was up 1.3% year-over-year in January, up from 0.6% in December. Core PCE (excluding food and energy) was up 1.7% in January, versus 1.4% in December. Though PCE remains below the Fed's 2.0% target for now, the trend suggests that inflation is moving slowly toward the Fed's target.

Retail Sales

The precipitous decline in oil prices may finally be providing a tailwind for consumer spending. On a year-over-year basis, retail sales were up 3.4% in January, vs. up 2.4% in December, suggesting that consumers were relatively undeterred by financial market volatility in January. On a month-over-month basis, retail sales, excluding autos and gas, were stronger than expected in January, up 0.4% on a month-over-month basis. Expectations were for a 0.3% gain. Overall retail sales, including autos and gas, were up 0.2% in the month.

Labor Market

Nonfarm payrolls rose by 242,000 in February, exceeding the consensus forecast of 195,000. December and January payrolls were also revised up by a total of 30,000. The unemployment rate was unchanged at a low level of 4.9% in February, while the participation rate continued to inch up to 62.9% from 62.7%. 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, declined to 9.7% from 9.9%. Wages declined 0.1% in February, missing expectations for a 0.2% increase, but this follows a strong 0.5% surge in wages in January. Over the past three months, payrolls have increased by an average of 228,000 per month, compared to the trailing six-month average of 235,000.

Housing Starts

Total housing starts declined 3.8% on a month-over-month basis in January, missing expectations. Single-family housing starts fell 3.9% while multi-family starts fell 3.7%. Housing starts tend to be volatile on a month-to-month basis, but the underlying trend remains modestly positive with total housing starts up 1.8% on a year-over-year basis. Overall, we believe housing market trends remain healthy.

Credit Spreads Widened in February

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change (%)
3-month top-rated commercial paper	0.18	0.16	0.02
2-year A corporate note	0.69	0.67	0.02
5-year A corporate note	1.05	1.03	0.02
5-year Agency note	0.23	0.21	0.02

Source: Bloomberg *Data as of 2/29/2016*

Economic Data Remains Indicative of Slow Growth

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(45.7) $Bln JAN 16	(44.7) $Bln DEC 15	(43.6) $Bln JAN 15
GDP	1.0% DEC 15	2.0% SEP 15	2.1% DEC 14
Unemployment Rate	4.9% FEB 16	4.9% JAN 16	5.5% FEB 15
Prime Rate	3.5% FEB 16	3.5% JAN 16	3.25% FEB 15
CRB Index	163.22 FEB 16	166.75 JAN 16	244.08 FEB 15
Oil (West Texas Int.)	$33.75 FEB 16	$33.62 JAN	$49.76 FEB 15
Consumer Price Index (y/o/y)	1.4% JAN 16	0.7% DEC 15	(0.1%) JAN 15
Producer Price Index (y/o/y)	(1.2%) JAN 16	(2.7%) DEC 15	(3.0)% JAN 15
Dollar/EURO	1.09 FEB 16	1.08 JAN 16	1.12 FEB 15

Source: Bloomberg