CHANDLER ASSET MANAGEMENT

May 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.

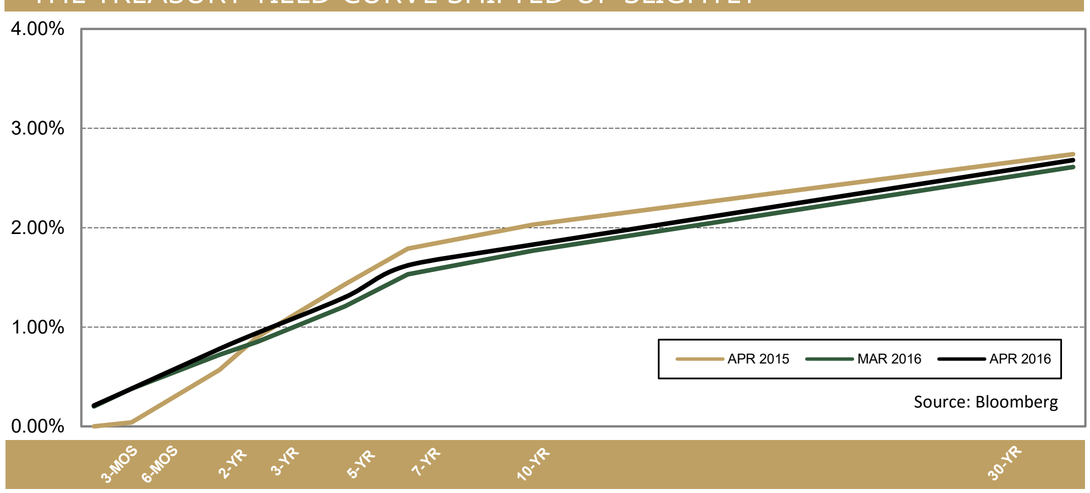
Market Summary

The Federal Open Market Committee (FOMC) left policy rates unchanged at its April meeting. Kansas City Fed President Esther George was again the lone dissenter, preferring to see the fed funds rate increase by 0.25%. The Fed downgraded its assessment of the overall economy in its policy statement, noting that economic activity "appears to have slowed." The FOMC continues to closely monitor the global economy, but removed language that was included in the March policy statement suggesting that global economic conditions posed risks to the domestic economy. We believe the FOMC has left the door open for a 25 basis point rate hike in June. However, given that inflation continues to run below the Fed's 2.0% target, job growth was lower than expected in April, and recent economic data has been somewhat sluggish, the next rate hike could be delayed. Global economic developments including the Brexit vote in June, as well as the Bank of Japan and European Central Bank monetary policy meetings next month could also influence the Fed's policy decision.

Domestic economic data continues to point to slow growth. Labor market trends remain favorable (with payrolls up an average of 200,000 per month over the past three months) and consumer confidence is solid. However, consumer spending trends have been lackluster and housing data has been bumpy. Manufacturing trends have improved but remain weak. Meanwhile, inflation pressures are contained, with the Core PCE index up just 1.6% year-over-year in March. First quarter 2016 GDP grew at a sluggish pace of 0.5%, following growth of 1.4% in the fourth quarter. Market participants are forecasting a modest rebound in GDP growth in the second quarter of 2016 of 2.3%.

In April, the Treasury yield curve shifted up slightly, with the 2-year Treasury yield up just six basis points and the 10-year Treasury yield up about seven basis points. Most market participants currently expect the Fed to keep policy rates on hold for the foreseeable future. Inflation remains contained for now, which gives the Fed more leeway to remain highly accommodative. However, labor market conditions are near those consistent with maximum sustainable employment, which leaves the door open for the Fed to continue normalizing monetary policy this year. In our view, two rate hikes before year-end are still possible (which would align with the FOMC's central tendency projection), and at least one is likely. Economic data is generally in line with the FOMC's most recent projections. As such, we believe the Fed will be forced to alter its message and revamp its economic projections in June if they do not hike rates.

THE TREASURY YIELD CURVE SHIFTED UP SLIGHTLY



In April, Treasury yields were little changed with the curve shifting up slightly. Over the past three months, the yield curve flattened slightly with the 2-year Treasury yield virtually unchanged and the 10-year Treasury yield down about 9 basis points. Over the past year, Treasury yields have been affected by weak global economic growth, volatile commodity prices, and divergent global central bank monetary policy. These issues continue to fuel financial market volatility.

TREASURY YIELDS	4/30/2016	3/31/2016	CHANGE
3 Month	0.21	0.20	0.01
2 Year	0.78	0.72	0.06
3 Year	0.94	0.85	0.09
5 Year	1.30	1.21	0.09
7 Year	1.62	1.53	0.09
10 Year	1.83	1.77	0.06
30 Year	2.68	2.61	0.07

Source: Bloomberg

Economic Roundup

Consumer Prices

Inflation pressures remain contained. The Consumer Price Index (CPI) was up just 0.9% year-over-year in March, vs. 1.0% in February. Core CPI (CPI less food and energy) was up just 2.2% year-over-year in March, vs. 2.3% in February. The Personal Consumption Expenditures (PCE) index was up 0.8% year-over-year in March, vs. up 1.0% in February. Core PCE (excluding food and energy) was up 1.6% year-over-year in March, vs. up 1.7% in February. These indices suggest that inflation moved further away from the Fed's longer-term 2.0% target in March.

Retail Sales

Retail sales trends remain underwhelming. On a year-over-year basis, retail sales were only up 1.7% in March, down from 3.7% in February. Excluding gas, retail sales were up 3.3% in March, down from 5.4% in February. Retail sales declined 0.3% on a month-over-month basis in March, below expectations for a 0.1% increase.

Labor Market

Nonfarm payrolls rose by 160,000 in April, lower than the consensus forecast of 200,000. February and March payrolls were revised down by a combined total of 19,000. The unemployment rate was unchanged at 5.0%. The participation rate inched down to 62.8% from 63.0%. 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 9.8%. Wages rose 0.3% in April, in line with expectations, following growth of 0.2% in March. Over the past three months, payrolls increased by an average of 200,000 per month, compared to the trailing six-month average of 220,000. Although the April jobs report was arguably weaker than expected, wage growth was favorable, the gap between the official unemployment rate and the U-6 narrowed, and nonfarm payrolls have grown at a solid pace on a trailing 3- and 6-month basis.

Housing Starts

Total housing starts declined 8.8% on a month-over-month basis in March, well below expectations. Single-family housing starts declined 9.2% while multi-family starts declined 7.9%. Housing starts tend to be volatile on a month-to-month basis and the data is subject to revision. On a year-over-year basis, housing starts were up 14.2% in March. Although housing starts were weak in March, we believe underlying trends in the housing market remain healthy.

Credit Spreads Tightened in April

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change (%)
3-month top-rated commercial paper	0.29	0.29	0.00
2-year A corporate note	0.46	0.57	(0.11)
5-year A corporate note	0.71	0.85	(0.14)
5-year Agency note	0.15	0.19	(0.04)

Source: Bloomberg *Data as of 4/30/2016*

Economic Data Points to Slow Growth

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(40.4) $Bln MAR 16	(47.0) $Bln FEB 16	(52.2) $Bln MAR 15
GDP	0.5% MAR 16	1.4% DEC 15	0.6% MAR 15
Unemployment Rate	5.0% APR 16	5.0% MAR 16	5.4% APR 15
Prime Rate	3.5% APR 16	3.5% MAR 16	3.25% APR 15
CRB Index	184.61 APR 16	170.52 MAR 16	229.48 APR 15
Oil (West Texas Int.)	$45.92 APR 16	$38.34 MAR 16	$59.63 APR 15
Consumer Price Index (y/o/y)	0.9% MAR 16	1.0% FEB 16	(0.1%) MAR 15
Producer Price Index (y/o/y)	(1.9%) MAR 16	(1.9%) FEB 16	(3.3%) MAR 15
Dollar/EURO	1.15 APR 16	1.14 MAR 16	1.12 APR 15

Source: Bloomberg