Third Quarter 2011 Market Review

Unfortunately, economic and market activity were not the main market drivers this quarter. Looking back, our analysis points primarily to politics, both at home and abroad. Be it Congress, the Administration, the FED or the European Union, we are experiencing an outright battle between the market place and the government for control of the economy. While the battle rages, we, the investor, are playing in a market filled with uncertainty.

For the first time in our history, our debt was downgraded from AAA. True, we have a very serious debt problem, but S&P also attributed the rating change to "…….what we see as America's governance and policymaking becoming less stable, less effective and less predictable than what was previously believed." The same can be said for our European friends. We also saw the FED announce for the first time a commitment to keep interest rates low through 2013. Why? To give our politicians on both sides of the aisle time to agree on policies affecting our economy and our future.

After two rounds of quantitative easing by the FED, short term interest rates cut to nearly zero and almost $1 trillion in economic stimulus, we are still experiencing low economic growth, weak housing and high unemployment. To remove this market uncertainty the investor needs to see a substantial improvement in the global economy. This can be accomplished if our government establishes policies that motivate the private sector to drive economic output and employment.

Looking at the markets, we saw a flattening of the Treasury yield curve due to movement in the long end of the curve. The 30 year moved from 4.39% to 2.91%, a huge drop, thus producing some of the largest quarterly gains in history. As a result, investment grade corporates with lower risk profiles saw gains for the quarter easily outperforming their lower quality counterparts. Further, the FED commitment of low rates until 2013 and Operation Twist gave way to a stellar performance by longer corporates (10 years or longer) which posted a quarterly total return of 8.4%.

We remain cautious until we see clear signs of economic improvement. Our buying bias continues to be low leveraged investment grade corporates and short duration agency mortgage products.