



# PORTFOLIO MANAGER'S REPORT



Tuesday May 11, 2010 9:25 AM

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## CURRENT OFFERING YIELDS - Tuesday: 05/11/2010 9:25 AM

## TODAY'S ECONOMIC DATA

	Trsy (Last Price)	Change (From Yest)	Agcy NC (Bullets)	Muni - TEY (A1; GO; BQ)	CMO (Avg Life)	MBS (Avg Life)			
3 mo	0.145%	-0.70 bp's	0.173%	0.495%			11-May	NFIB Small Business Optimism	Prior: 86.8 Actual: 90.6
6 mo	0.221%	-0.50 bp's	0.249%	0.586%			11-May	Wholesale Inventories	Prior: 0.6% Actual: 0.4%
12 mo	0.376%	-0.3 32'ds	0.533%	0.798%			11-May	IBD/TIPP Economic Optimism	Prior: 48.4 Actual: 48.7
2 yr	0.847%	+ 1.0 32'ds	1.054%	1.344%	1.747%	1.797%			
3 yr	1.316%		1.508%	1.960%	2.316%	2.416%			
5 yr	2.253%	+ 1.5 32'ds	2.417%	3.192%	3.103%	3.403%			
10 yr	3.541%	+ 1.5 32'ds	3.756%	5.117%	4.491%	4.541%			
30 yr	4.417%	UNCH	4.950%	6.965%					
							DJIA	10,748.71	-36.43
							NASDAQ	2,367.07	-7.60
							S & P 500	1,155.89	-3.84

Source: Bloomberg Fair Value Curve or Last Price (Treasury only); ALL yields and spreads are "representative", not actual. Spreads change as the market changes, actual offerings may be higher or lower than

## TODAY'S NEWS

### Treasury Shorter-Term Notes Rise as Euro's Decline Rekindles Debt Concern

May 11 (Bloomberg) -- Treasury shorter-term notes rose as the euro's decline stoked concern that an almost \$1 trillion European Union rescue package will fail to end the region's sovereign-debt crisis. Three- and five-year securities led the gains as stocks retreated, fueling demand for the relative safety of U.S. debt. The advance came even as the Treasury prepared to auction \$38 billion of 3-year notes today, to be followed by sales of 10- year securities tomorrow and 30-year bonds on May 13.

### Today's Topic: FNMA and FHLMC Updates

In an effort to keep you abreast of developments with FNMA and FHLMC, below are excerpts from an article that appeared on Bloomberg yesterday. Many investors have significant commitments in these two agencies that are at the center of the financial problems that have surfaced over the past three years. The information below is presented to better inform you as you form your investment decisions going forward.

Freddie Finances Scarier Than Bad Slasher Flick: Kevin Hassett  
2010-05-10 01:00:28.0 GMT

Commentary by Kevin Hassett

May 10 (Bloomberg) -- Freddie Mac's disclosure that it lost \$6.7 billion of taxpayer dollars in the first quarter of 2010, and that bigger losses may follow, suggests the Congressional Budget Office may have been kind in estimating that Freddie and Fannie Mae could gobble up \$389 billion in U.S. aid by 2019.

The carnage of America's government-sponsored housing agencies continues. It's a remake of "A Nightmare on Elm Street," only Freddy Krueger now goes by Freddie. The hapless victims are played by taxpayers.

The two mortgage giants that largely created this mess chug along enthusiastically, not even bothering to change key practices that led to the worst real-estate crisis in U.S. history. Not only have Democrats failed to address Fannie and Freddie in their financial reform, they are standing back and allowing the worst practices to go on.

And while the rest of the economy has turned the corner, the bleeding is getting worse at the government housing agencies.

Incredibly, the Obama administration has done nothing to stop Fannie and Freddie from engaging in these dangerous practices. Quite the opposite.

In February, the Federal Housing Finance Agency proposed a rule setting goals for Fannie and Freddie for 2010 and 2011. One goal is that 27 percent of mortgages acquired by Fannie and Freddie "meet the low-income standard."

In other words, not only are your tax dollars going to bail out the horrifying loans that Fannie and Freddie encouraged during the real-estate bubble, they are also being used to guarantee new loans to borrowers who would not qualify absent government intervention.

The Democrats have put off dealing with Fannie and Freddie for a simple reason: Reform will require a conversation on how the two organizations contributed to the financial crisis.

Such a discussion is inconsistent with the Democratic story that Republican deregulation created the mess. It's especially painful for President Barack Obama, who was a strong advocate for the two mortgage giants and helped obstruct efforts to rein them in. As of 2008, Obama trailed only Senator Christopher Dodd of Connecticut, chairman of the Senate Banking Committee, in collecting political donations from Fannie and Freddie's employees and political action committees.

My guess is that Democrats will continue to avoid doing anything about Fannie and Freddie. The two leaking organizations will be cut into pieces and sent to the bottom of the ocean only after Republicans recapture Congress. Dire financial reports, such as Freddie's last week, may hasten that transfer of power.

(Kevin Hassett, director of economic-policy studies at the American Enterprise Institute, is a Bloomberg News columnist. The opinions expressed are his own.)

Our observations:

The Bad News...

As related in the article excerpts above, the bleeding goes on. As just announced for the first quarter, 2010, FNMA lost 11.5 billion and FHLMC lost 6.7 billion. The inaction of the Obama administration suggests the government is intent on deferring any meaningful reform of FNMA and FHLMC. Instead, the recurring losses are announced each quarter and injections of capital are then made to enable the two agencies to continue their roles in the U. S. housing industry and it's hoped for recovery. The activities continue with the backdrop of both agencies residing in the conservatorship with either explicit or implicit backing of the government until December 31, 2012. After that, the government will not say.

The Good News...

The bond market does not perceive any imminent danger of the government removing their backing of the two agencies. Consequently, spreads on their debt continue to be steady and consistent which indicates a belief that the financial support will continue at least in the foreseeable future. If there was a real concern, spreads would already have widened significantly against treasuries and the debt issues of the other agencies. The markets have a good track record of sniffing out the facts before press releases are ever written.

Conclusion...

Prudence in bond portfolio management has always suggested diversification and minimization of risk, whether the risk is immediate or yet to appear in clear view. With a government, FED, and Treasury that have enacted heretofore unheard of measures conflicting with private ownership and basics of American capitalism, logic leads one to be more confident in FNMA and FHLMC in the short term versus the longer. **The establishment of the agencies in the conservatorship until December 31, 2012, provides a date of importance in considering the future viability of FNMA and FHLMC.** Keep abreast of quarterly earnings and statements of the government concerning the roles of the two agencies in the future.