



# PORTFOLIO MANAGER'S REPORT



Thursday, August 12, 2010 10:20am

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## CURRENT OFFERING YIELDS - Wednesday: 08/11/2010 8:48 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)	12-Aug	Import Price Index (MoM) Prior: -1.3% Actual: 0.2%
3 mo	0.145%	+ 0.50 bp's	0.135%	0.465%		12-Aug	Import Price Index (YoY) Prior: 4.5% Actual: 4.9%
6 mo	0.181%	UNCH	0.173%	0.480%		12-Aug	Initial Jobless Claims Prior: 479K Actual: 484K
12 mo	0.226%	-0.3 32'ds	0.325%	0.571%			
2 yr	0.489%	+ 2.0 32'ds	0.647%	0.905%	1.289%		
3 yr	0.792%		0.971%	1.430%	1.592%		
5 yr	1.397%	+ 4.3 32'ds	1.619%	2.480%	2.247%		
10 yr	2.699%	+ 4.3 32'ds	2.978%	4.617%	3.499%		
30 yr	3.963%	+ 17.0 32'ds	4.597%	6.950%	3.699%		
						DJIA	10,442.94 -201.31
						NASDAQ	2,222.93 -54.24
						S & P 500	1,098.20 -22.86

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 Two-Year Yields Near Record Low as U.S. Jobless Claims Increase

Aug. 12 (Bloomberg) -- Treasury two-year note yields were within two basis points of the all-time low as a government report showed initial jobless claims unexpectedly rose, adding to concern the U.S. recovery is stalling. Yields on 30-year bonds touched the lowest level in three weeks before the Treasury sells \$16 billion of the securities today. The Federal Reserve said on Aug. 10 it would reinvest principal payments on mortgage assets into U.S. debt to support the economy by lowering borrowing costs.

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

In a continued effort to keep you abreast of developments with FNMA and FHLMC, below is an update article that appeared on Bloomberg this week. 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.

TEL Freddie Mac Seeks New \$1.8bn Bail-out  
Aug 9 2010 15:51:49

Angela Monaghan

Aug. 9 (Telegraph) -- Mortgage lending giant Freddie Mac is seeking \$1.8bn (£1.1bn) in aid from the US Government after bad home loans prompted its fourth consecutive quarterly loss.

The country's second-largest mortgage finance company said it would call on the US Treasury for funding after a \$4.7bn net loss in the second quarter, and expects to receive the funds by the end of September. The performance in April to June compared with a \$6.7bn loss in the first quarter.

"We recognise that high unemployment and other factors still pose very real challenges for the housing market, and with that in mind, we continue to focus on the quality of the new business we are adding to our book to be responsible stewards of taxpayer funds as we support the nation's housing market," said chief executive Charles E. Haldeman, Jr.

Freddie Mac and larger rival Fannie Mae were bailed out by the US Government in 2008 when the sub-prime mortgage crisis which triggered a global downturn threatened to drive them to collapse. Together they own or guarantee more than half of the \$11 trillion US residential debt market.

Fannie Mae said last week it would seek an additional \$1.5bn in aid from the Treasury after reporting a \$1.2bn second-quarter net loss. In total, the two companies have sought almost \$150bn in Government funding.

"Freddie Mac continues to support the still-fragile housing market by providing America's families with access to affordable home financing and foreclosure alternatives," Mr Haldeman said in a statement on Monday.

He added that Freddie Mac had helped more than 150,000 struggling borrowers to avoid foreclosure and provided funding that enabled more than 865,000 US households to buy or rent a home in the first half of the year.

"At the same time, we are promoting sustainable homeownership by helping families buy homes that they can afford and keep for the long term," he added.

In June, Freddie Mac and Fannie Mae were forced to delist from the New York Stock Exchange after they failed to meet minimum price guidelines.

Next week President Barack Obama's administration is scheduled to host a meeting of elected representatives, financial executives and housing experts to discuss possible improvements to the US mortgage finance system following the crisis and subsequent bail-outs of Freddie Mac and Fannie Mae.

Timothy Geithner, the US Treasury Secretary, has said that he is hoping for a "comprehensive reform proposal" for the two companies by January.

-0- Aug/09/2010 19:51 GMT

## Our observations:

### The Bad News...

As related in the article above, the bleeding continues. As just announced for the second quarter, 2010, FNMA lost 1.2B and FHLMC lost 4.7B. While both numbers were not as bad as the previous quarter (11.5B for FNMA and 6.7B for FHLMC), the magnitude of the losses are still staggering. The Obama administration has provided rhetoric suggesting that the problems with the two mortgage giants will be dealt with but still no meaningful reform has come forth. As the article relates, Timothy Geithner is now saying that he is hopeful that "a comprehensive reform proposal" for the two companies will be put forth by January.

### The Good News...

The bond market still does not perceive any imminent danger of the government removing their backing of the two agencies. Consequently, as in the past, 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. As we have stated before, if there was a real concern, spreads would already have widened significantly against treasuries and the debt issues of the other agencies.

If the markets sniff a problem with default or waning support of the government, spreads will widen very, very quickly.

### Conclusion...

As we stated in prior months and continue to believe, 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.** Importantly, we will need to see if the administration develops a reform package by January as promised and what it means. Keep abreast of quarterly earnings and statements of the government concerning the roles of the two agencies in the future.