



PORTFOLIO MANAGER'S REPORT



Tuesday August 24, 2010 8:32 AM

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CURRENT OFFERING YIELDS - Tuesday: 08/24/2010 8:32 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)	24-Aug	Existing Home Sales Prior: 5.37M Actual: ---
3 mo	0.142%	- 0.50 bp's	0.145%	0.465%		24-Aug	Existing Home Sales MoM Prior: -5.1% Actual: ---
6 mo	0.181%	- 0.50 bp's	0.178%	0.526%		24-Aug	ABC Consumer Confidence Prior: -45 Actual: ---
12 mo	0.233%	-0.1 32'ds	0.335%	0.647%			
2 yr	0.462%	+ 1.0 32'ds	0.627%	0.965%	1.262%		
3 yr	0.760%		0.946%	1.410%	1.560%		
5 yr	1.356%	+ 3.5 32'ds	1.584%	2.298%	2.206%		
10 yr	2.525%	+ 3.5 32'ds	2.783%	4.374%	3.325%		
30 yr	3.603%	+ 20.5 32'ds	4.247%	6.859%			
						DJIA	10,092.83 -81.58
						NASDAQ	2,131.66 -27.97
						S & P 500	1,057.16 -10.20

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

Treasuries Rise on Economic Concern, Pushing 10-Year Yield to 17-Month Low

Aug. 24 (Bloomberg) -- Treasuries rose, pushing the yield on the 10-year note to the lowest level since March 2009, as concern the U.S. recovery is stalling encouraged demand for the relative safety of government debt. The yield on the two-year note was within two basis points of its all-time low as the government prepared for a \$37 billion auction of the maturity today. The dollar dropped to a 15-year low versus the yen and U.S. stock-index futures retreated before an industry report forecast to show sales of previously owned homes in the U.S. plunged in July.

Today's Topic- Think Rates Can't Go Any Lower?

Many Portfolio Managers have had the mindset that they can simply wait out this low rate environment, and admittedly it sometimes feels as though yields couldn't get any lower...

Although the natural tendency would be to try to shrink the bank, many are finding this to be a much tougher task than imagined. Balance sheets have been building up cash in anticipation of rising loan demand or interest rates. The reality is, an extended low rate environment with flat loan growth may very well hurt bank earnings more than missing out on a much anticipated return to higher rates. Here's why, waiting for higher rates forces short term yields on the earning structure today (either Fed Funds or short investments) generally at lower rates than we are able to maintain on our next marginal dollar on deposit (negative spread). We sacrifice earnings today looking for that one big payday when we are able to reinvest at higher rates, however if that day doesn't come (or at least not in the near future) we will eventually capitulate and decide that we can't wait any longer. Unfortunately, this usually occurs AFTER rates have dropped even more. This is not a new phenomenon, it happens virtually every time we enter into a "new low" in the rate cycle. The consequences this time could be perilous, if this lack of earning is coupled with continued struggles with asset quality. Foregoing earnings today because we are afraid of tomorrow's market losses could mean we lose twice.

If we can't shrink the balance sheet enough to dispel excess liquidity (depositors have very few options available to them as well) then we may eventually be forced to invest in yields we like even less than those available today.

Many market "guru's" easily dismiss the Japanese scenario, saying it can't happen here. That may be, but looking at the graph below of the Japanese 10 year bond scares the stuffing out of me...

