



Continued deterioration amid massive non-monetary policy

Another month of bleak economic information led risk assets lower as investors saw further declines in economic activity, confidence and trust. Globally, central bankers and policy makers continue to implement monetary and fiscal policy at the most accommodative pace in modern history. A self feeding downward spiral of collapsing demand, rising layoffs and deteriorating confidence is at hand. On the policy front, the U.S. Treasury announced further plans to assist the weakened banking sector in an attempt to revitalize securitization and forestall nationalization with the Capital Assistance Program and the Financial Stability Plan.

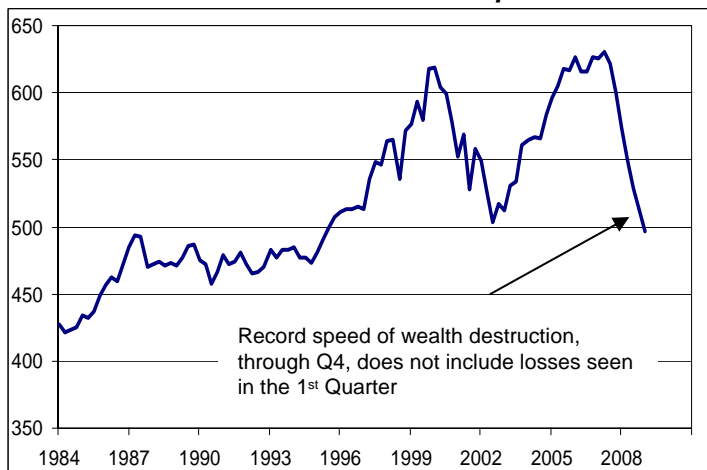
The economic information in February continues to deteriorate:

- Industrial production has collapsed more 10% year-over-year
- 4th Quarter GDP was revised down to -6.2%
- Household net worth is estimated to have fallen \$11 trillion in 2008, a record
- S&P 500 has retraced back to 1996 levels
- February non-farm payroll estimates are for a -650k job loss, a potential record following two consecutive 500k+ monthly declines
- Unemployment claims, a leading indicator, have risen to a 28 year high
- Consumer Confidence fell to 25, the lowest on record back to 1967
- Reported earnings based on the S&P 500 are expected to contract more than 50% year-over-year through the 1st Quarter of 2009, a record decline
- Home price deflation accelerated in February, reporting a decline of -18.6% year-over-year
- The coincident index for Philadelphia PMI in January showed not a single state as recording increasing economic activity, a first since 1979

Economic indicators are firmly in contraction and policymakers race towards 0%

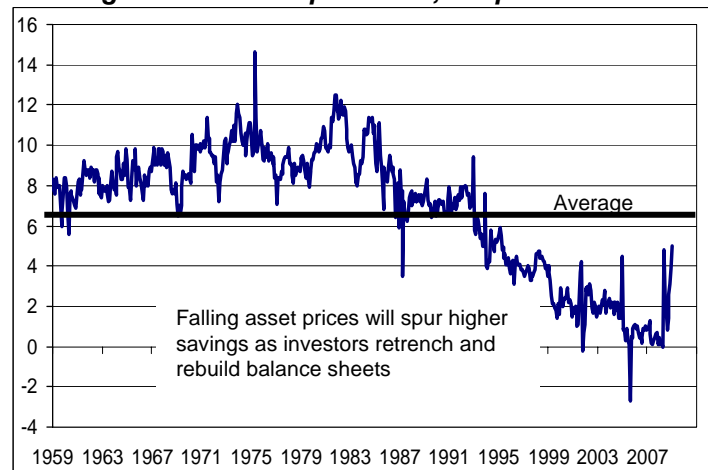
There is little to cheer on the economic front. Companies, who were caught in Q4 with significant inventories have cut production, hiring and capacity. Couple this with broken financial intermediation such as securitization and lending and economic activity has ground to a halt. It would be difficult, in some data impossible, for the downward year-over-year change to continue at this rate, but all measures are firmly in contraction. Globally the picture is even worse, indicated by the strength of the U.S. dollar as trade volume's plunge, capital flows shrink, and net exports collapse. Central bankers in the G-10 are in a race towards 0% policy rates.

Household net worth as a % of disposable income



Source: Federal Reserve

Saving more as asset prices fall, the paradox of thrift



Source: Federal Reserve



Another round of plans designed to support financial institutions

Globally, enormous sums of money are being put to work by governments in an effort to replace shrinking private sector demand. The Bank of England, faced with significant contraction of the UK economy has lowered borrowing rates to 0.50%. This is the lowest level of interest rates in the history of that institution, going back to 1694. Furthermore, continued 'credit easing' is underway as central bankers push aggressive non-monetary measures. The most recent effort was the February 10th announcement of the Financial Stability Plan. This plan takes a three part approach to address both the ever creeping nationalization threat coupled with the need to restart securitization. Highlights of the program include diverting \$200b of funds to create a new TARP plan to directly look to restore liquidity and lending to consumers. The plan will also put financial institutions under stress tests to determine their needs for capital, and provide preferred equity to banks with a warrant to buy up to 20% of common equity if needed. ***The program, while another significant effort by policy makers to support financial markets fell short in regards to its guarantees of bank liabilities and its removal of difficult to value, level 3 assets from bank balance sheets.***

Inflationary concerns are not justified by the data

Money supply measures such as M2, monetary base and excess bank reserves ballooning over the past six months continues to spur concerns of inflation, as countries fight aggressively to ward off a debt deflation spiral. In the middle of 2008, many market participants were worried that soaring commodity prices would lead to inflation. We did not share this concern as we focused on the measures of inflation that are structural, not cyclical, including; unit labor costs, output gap, capacity utilization, and wage growth. With the current transition mechanisms of monetary policy broken as securitization has ceased, demand and availability of capital weak, and the significant deflationary forces of a recession at work, inflationary concerns in the short term are not justified by the data.

The long run implications of significant deficits are disturbing

The long run implications of fiscal policy that are sending deficits to post war highs are disturbing. In addition, the implications of the serious loss of manufacturing capacity, production and employment should economic activity accelerate and the banking system improve in the next few years could close output gaps and stoke inflation. However, we are in a period in which policy makers will do whatever it takes to prevent deflation and this will drive monetary and fiscal policy in 2009 and likely 2010. The concerns that longer term this "all in" approach will create inflation are warranted but until financial intermediation returns and economic growth stabilizes policymakers will continue to do what is necessary today, at the potential risk of causing serious longer term problems in the future.

The next thirty years will not be like the past thirty

In summary, February continued to provide little data that has driven us to take more portfolio risk or materially change our positioning. There is a traditional caveat in all marketing materials that past performance is not indicative of future results. ***Over the past thirty years, mild recessionary periods were common as ample monetary and fiscal stimulus coupled with factors such as technological innovation and rising productivity led to shallow recessions.*** According to the Bank Credit Analyst, the 10 defined recessions since WWII have averaged 10 months. However, going back to 1854, the 32 defined recessions average 17 months. We are now in month 15 of this downturn and employment, production, consumer spending and GDP continue to contract. It is certain we will experience the largest contraction in the past thirty years and it is becoming more realistic that an extended period of sub-par growth and consumer/balance sheet deleveraging is at hand. We will look to the economic data to drive our positioning, ever cognizant that the past thirty years of capital market expectations, returns and economics are not indicative of the next thirty.



Market commentary and portfolio positioning

Treasuries continue to be influenced by both severe risk aversion and ballooning supply

The Treasury market continued its upward trend in yields, in particular in the intermediate part of the curve. The Treasury market continues to be influenced by two equally significant factors; severe risk aversion and ballooning Treasury supply. Throughout 2009, we have maintained an underweight to Treasuries and focused on other areas of the Government sector, namely Agencies and Agency MBS. Agency MBS continue to perform well, outperforming all other sectors for the year as the sector is a focal point to reduce private sector borrowing costs.

Managing MBS in a time of Government intervention provides opportunities

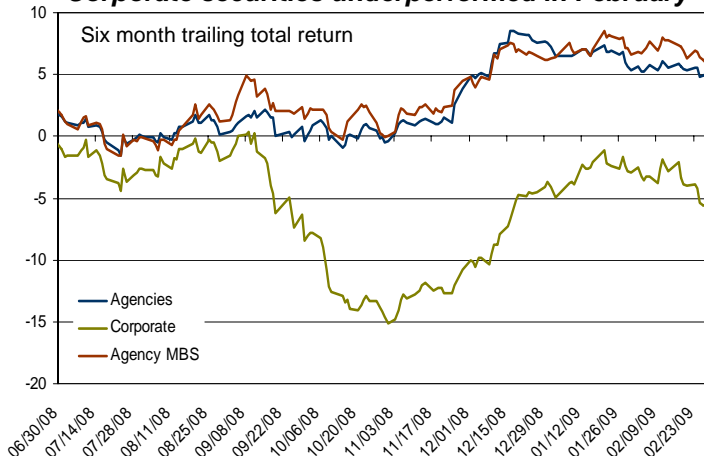
Through the TALF program the Treasury has announced purchase commitments of up to \$500b in an effort to reduce mortgage rates. Furthermore the U.S. Treasury has increased the commitments to the GSE's through an additional \$200b in new funding. Managing Agency MBS, the largest fixed income sector in the U.S, during a period where Government intervention is at work to drive down mortgage rates keeps us cautious and attentive to our positions. We are concentrating our MBS positions in securities that have lower pre-payment risk and high cash flows, including those securities that have characteristics that make them unavailable for the Government initiated programs such as seasoned vintages with lower loan balances and lower weighted average coupons.

We do not share the view that credit is excessively cheap

Entering 2009, many market participants believed corporate securities were poised to be significant outperformers. January saw an early realization of that assumption as credit outperformed. February experienced a reversal as the grim reality of the economic data trumped the hope of market participants. In particular High Yield securities, challenged the view of many that the sector was 'cheap' on a valuation basis. Rising defaults (e.g., Young Broadcasting, Spectrum Brands in February), economic weakness and accelerating ratings migration led to the sector producing a -3.10% return for the month.

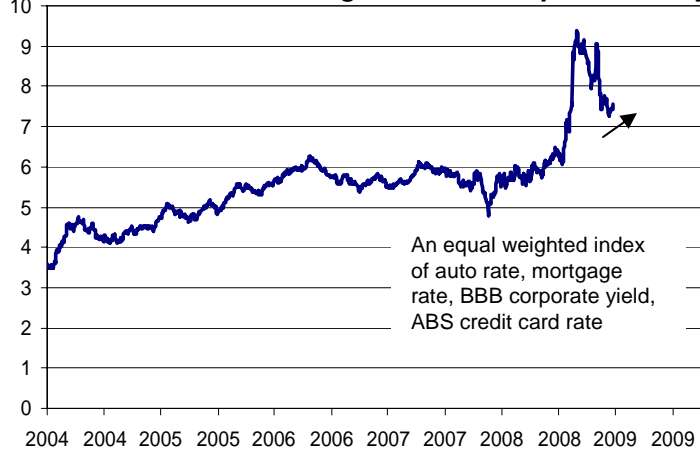
In addition, the uncertainty towards a potential nationalization of many leading financial institutions led to volatility and underperformance of bank debt in February. Corporate valuations have led us, for the portfolios where we employ credit, to reduce our long held underweight to a neutral weighting. However, we do not share many participants view that credit is excessively cheap. We continue to focus our corporate positions in bank senior debt and other defensive industries, including utilities and healthcare. We are cautious on consumer cyclical and discretionary names and hold a zero weighting in insurance companies.

Corporate securities underperformed in February



Source: Barclays

Private sector borrowing rates turned up in February



Source: Barclays



Key portfolio themes

- Underweight Treasuries, but to a lesser degree than in January
- Overweight Agencies (Fannie Mae, Freddie Mac)
- Yield curve positions focused on a steeping of rates
- Neutral duration relative to indices
- Moved investment grade portfolios to neutral weight in corporate bonds

Technical and valuation models indicated no clear trend in interest rates, warranting a neutral duration positioning

Government only mandates – we were significantly overweight Agencies and underweight Treasuries. We ended February with no out of index Agency MBS positions in the portfolios. The portfolios have been performing in line with their benchmark through the year, but are on path to a negative quarter as some of the flight to quality and significant performance seen in the 4th Quarter has receded as Treasury yields backed up.

Low duration mandates – we were significantly overweight Agencies and underweight Treasuries. These portfolios have had only a small negative impact due to the rise in Treasury yields. Due to their short duration and defensive positioning they were minimally impacted by rising rates.

Agency MBS continue to drive performance in AAA only mandates

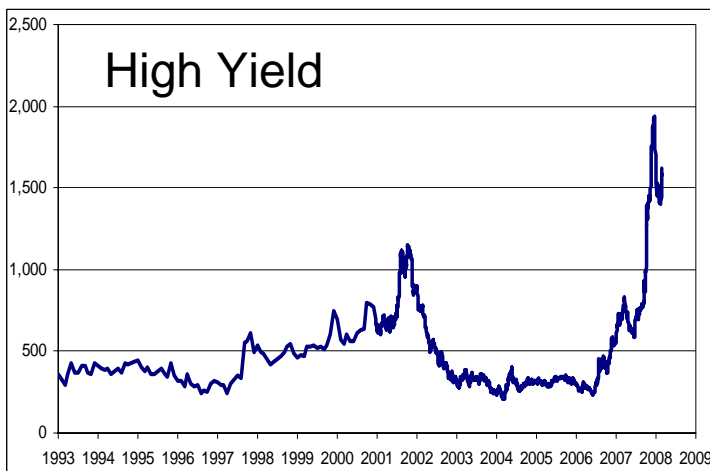
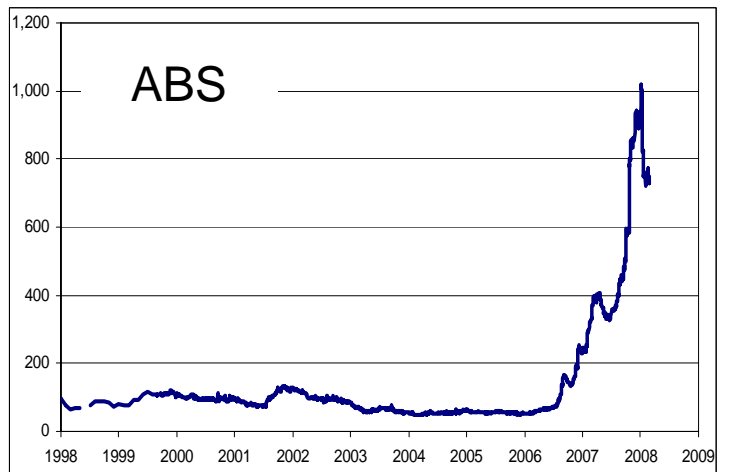
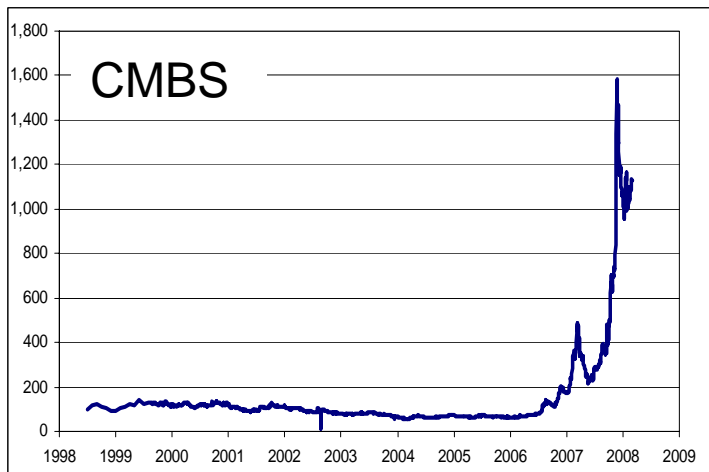
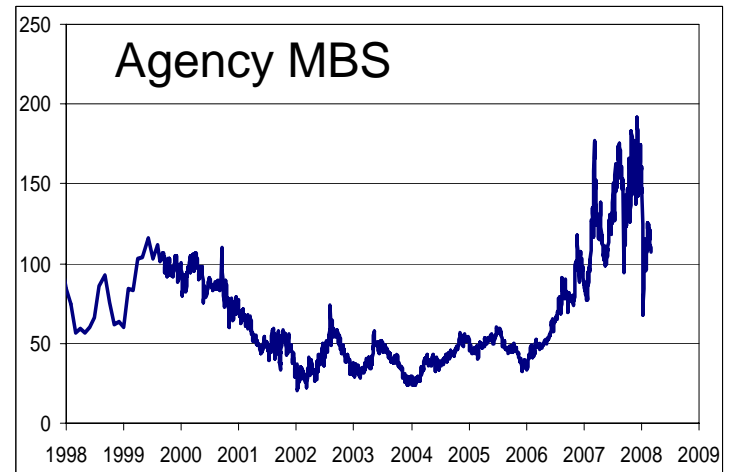
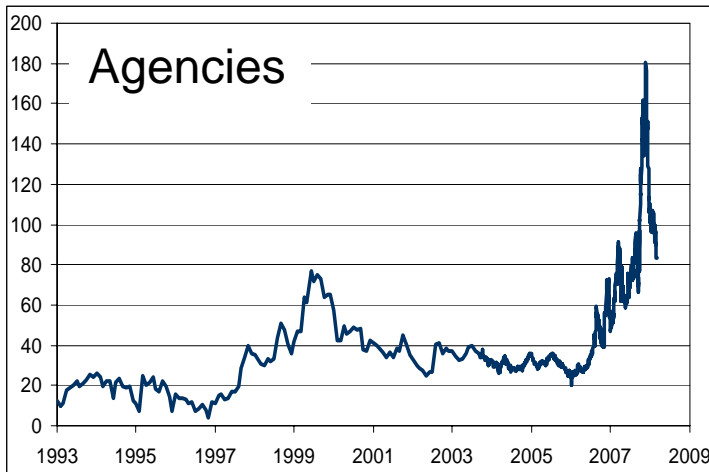
AAA only Aggregate and Intermediate Aggregate mandates – we were overweight Agencies, neutral Agency MBS and underweight Treasuries. February saw a continued backup in Treasury yields and we have reduced our underweight during the month. The portfolios benefited from no corporate bond exposure in February as credit related sectors underperformed.

We have moved to a neutral weighting in Corporate's, the first time in four years

Aggregate investment grade mandates – we were overweight ABS and Agencies, neutral in Agency MBS, Corporates and underweight Treasuries and CMBS. The investment grade portfolios underperformed in February due to security specific positions in credit and ABS. Our overweight to senior bank debt was a negative to performance in February. Ratings downgrades in the ABS sector, in which more than 1,000 ABS securities were downgraded influenced the underperformance of the sector in February. We have removed our four-year underweight in corporates, moving to a neutral weighting, primarily focusing in bank debt, utilities, and health care. Zero weighting in insurance companies.



Month end spreads of the major fixed income sectors



Macquarie Allegiance Capital

Economic and Financial Information



Economic Indicators	Current	Prior
	Feb-09	Jan-09
ISM	35.6	32.9
ISM prices paid	29.0	18.0
Factory Orders	-3.9%	-6.5%
Unemployment Rate	7.6%	7.2%
Change in NFP	-598K	-577K
Trade Balance	-\$39.9B	-\$41.6B
Producer Price Index (PPI) MoM	0.8%	-1.9%
Core* PPI MoM	0.4%	0.2%
Consumer Price Index (CPI) MoM	0.3%	-0.8%
Core* CPI MoM	0.2%	0.0%
CPI YoY	0.0%	0.1%
Core* CPI YoY	1.7%	1.8%
Retail Sales less Autos	0.9%	-3.2%
Industrial Production	-1.8%	-2.4%
Capacity Utilization	72.0%	73.3%
UoM Confidence	56.3	61.2
Housing Starts	466K	560K
Leading Indicators	0.4%	0.2%
Consumer Confidence	25.0	37.4
S&P/Case-Shiller Comp-20 YoY	-18.6%	-18.2%
New Home Sales	309K	344K
Durable Goods Orders	-5.2%	-4.6%
Chicago Purchasing Managers	34.2	33.3

*Less Food and Energy

Source: Bloomberg

Financial Indicators	Current	Prior
	Feb-09	Jan-09
Oil	44.37	41.71
CRB	211.75	220.40
JOC	67.55	68.88
Yen to Dollar	97.83	89.86
Euro to Dollar	1.2695	1.2793
DX	88.14	86.39

Quarterly Economic Indicators	Current**	Prior
	4Q08	3Q08
GDP - Real QoQ	-6.2%	-0.5%
GDP - Real YoY	-0.8%	0.7%
GDP - Nominal QoQ	-5.8%	3.4%
GDP - Nominal YoY	1.2%	3.3%
Non-Farm Prod QoQ	3.2%	1.5%

On the Run Treasury Yields	Current	Prior
	Feb-09	Jan-09
Fed Target Rate		0.25%
2-year	1.01%	0.95%
5-year	2.02%	1.86%
10-year	3.03%	2.84%
30-year	3.71%	3.60%

** Most recent number available, may be subject to change.

Source: Bloomberg

Barclay's Index Information	Duration	Monthly Return	YTD	Sector Excess Returns	Current	Year-to-
					Month	Date
Aggregate	4.13	-0.38	-1.26	Agency	0.62	0.68
Govt/Credit	5.19	-0.83	-2.35	Corporate	-1.43	2.31
Government	4.80	-0.27	-2.75	CMBS	-3.58	-5.61
Intermediate Aggregate	3.30	-0.21	-0.43	ABS	-0.72	6.62
Intermediate Govt/Credit	3.83	-0.60	-0.99	MBS	0.70	1.26
Intermediate Government	3.60	-0.18	-1.44			
1-3 Year Govt	1.82	0.04	-0.21			
U.S. MBS	2.64	0.58	0.77			
Corporate	5.98	-1.97	-1.52			
Majors Govts (ex U.S.)	6.67	-4.01	-7.87			
High Yield Bonds	4.08	-3.10	2.71			
Emerging Market	5.79	-1.55	0.58			

Source: Barclays

Source: Bloomberg

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