

Aureus Asset Management, LLC
Comments on Fixed Income Market
December 20, 2010

Given the recent volatility in fixed income markets and negative media coverage, Aureus felt it important to offer the following commentary.

While fixed income returns remain slightly positive for the year, bonds have lost most of the gains achieved from May through September. Fear of inflation and concerns over deficits, at the federal and municipal level, have exacerbated the situation.

We believe reports drawing comparisons between municipal finance and the sub-prime mortgage crisis are erroneous. Coverage ratios, revenue-generating powers, transparency, and fiscal condition combine to make local government finances superior to those of the housing market. We believe these attributes greatly reduce the risk of defaults on municipal debt issues.

At the national level, attention has focused on both the \$4 trillion US federal deficit and the large sovereign debts of many developed countries. Politicians have difficulty telling voters that real sacrifices are necessary to bring down our debt, including: spending cuts, a fundamental restructuring of social commitments (e.g. Social Security and Medicare/Medicaid), as well as inevitable revenue increases. The recent report of the Deficit Commission has made a strong first step in addressing some of these issues.

Historically low inflation is a near-term positive for bonds. Presently, Aureus does not forecast a significant rise in inflation as high unemployment and sluggish demand combine to keep prices muted. In addition, Treasuries and high-quality municipal bonds are still among the most secure investments available. Aureus believes the recent price volatility argues for actively-managed fixed income portfolios as credit analysis becomes increasingly important. Experienced investors can identify attractively priced bonds.

Given the historically low level of today's interest rates, and the sharp rally in fixed income over the past two years, we believe the expected total return on bonds is currently relatively modest. However, as mentioned above, inflation is also very low, and bonds offer less volatility than stocks or many alternative assets and they are usually very liquid. Aureus' separate portfolios are invested in high-quality municipals through our sub-advisor Breckinridge Capital Advisors (BCA) and through two high quality Vanguard bond funds.

Both BCA and the two Vanguard bond funds are at the top tier of the quality spectrum, and BCA takes advantage of movements in the municipal market, understanding the credit profiles of each issue held by our clients. We have utilized the Vanguard corporate bond funds for clients as a means to augment portfolio yield. We closely monitor the credit and maturity risk of these funds. The Aureus Fund includes managers who are experts at various segments of the fixed income market, taking advantage of opportunities created by volatile situations. Aureus continually re-examines allocations to fixed income and accesses the risks associated with each client's exposure to this asset class.