

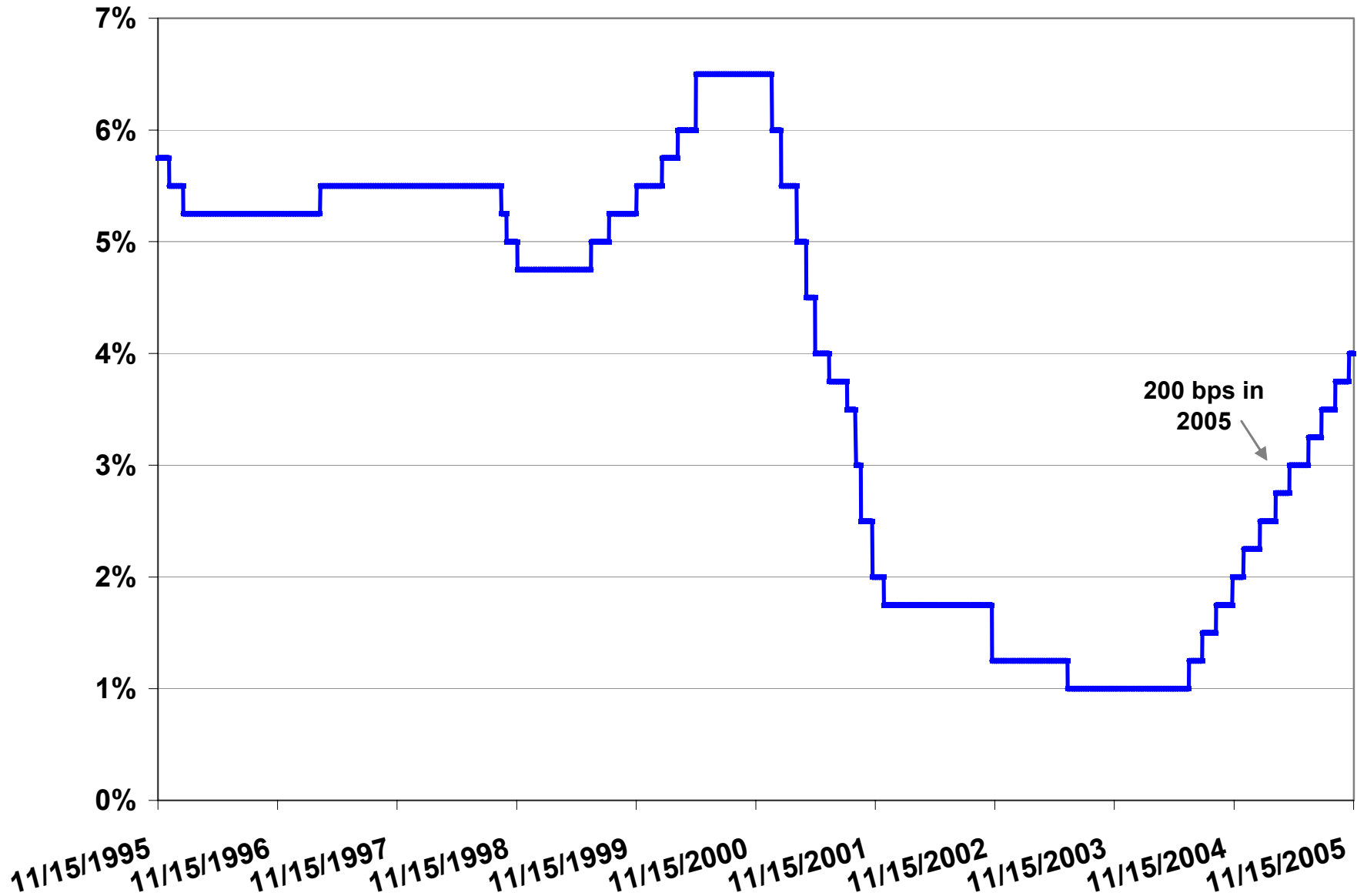
2005 Fixed Income Review

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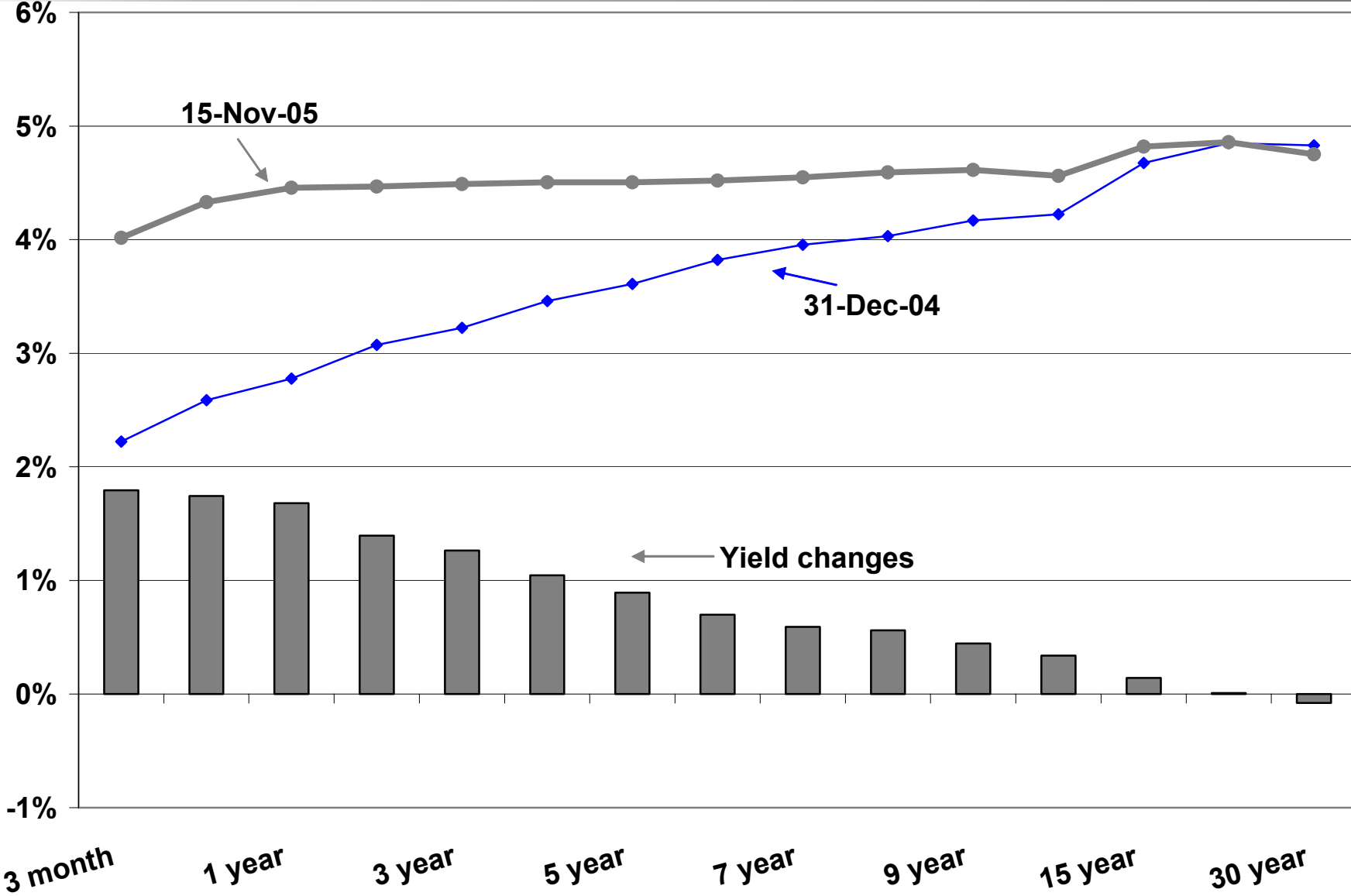
OVERVIEW OF PRESENTATION

- Fed tightening, effects on yield curve
- Volatility: Dead or alive?
- Fixed Income Returns
- Bonds, Bernanke, and baseball: boom time or boredom?

FED FUNDS TARGET RATE



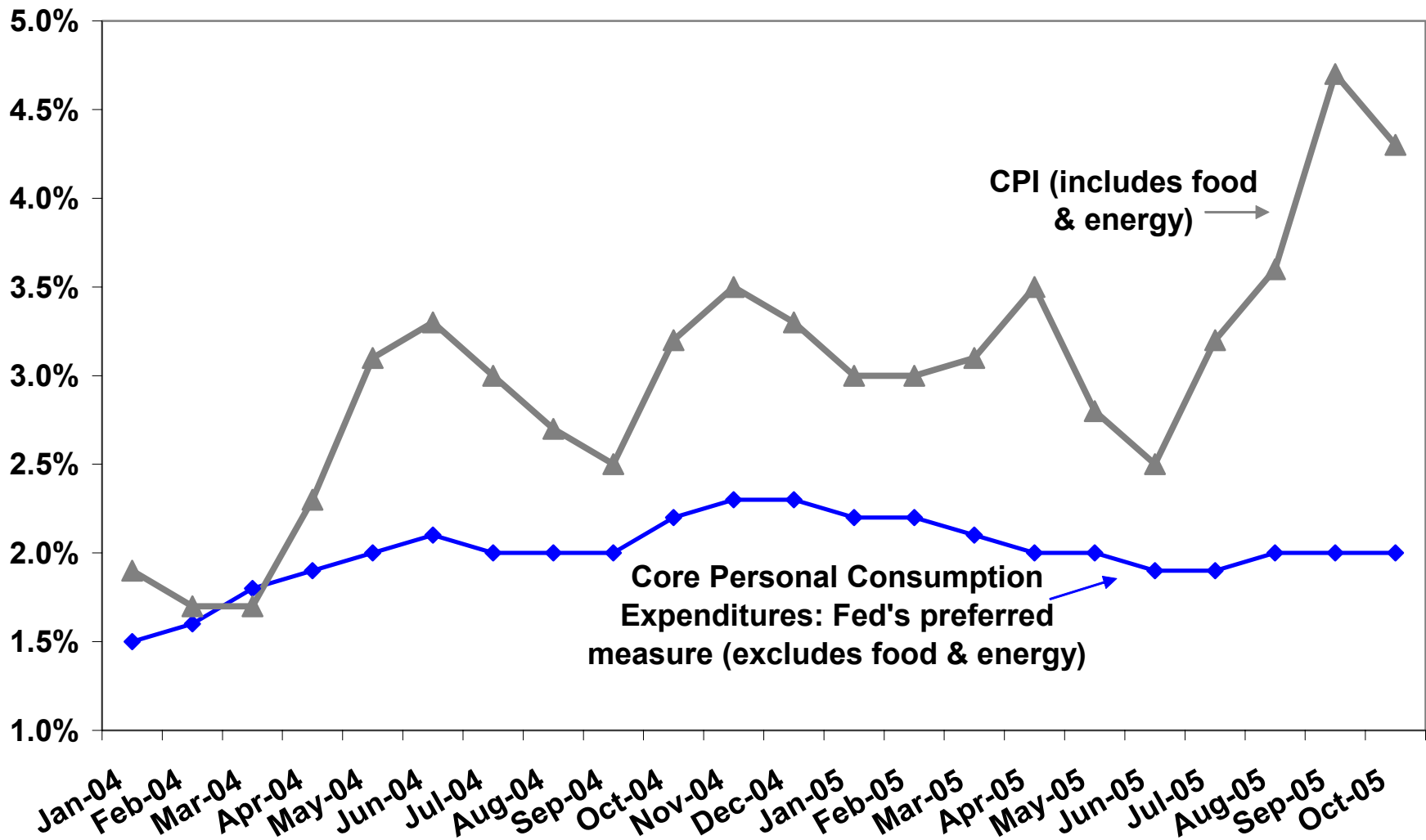
US TREASURY YIELD CURVE



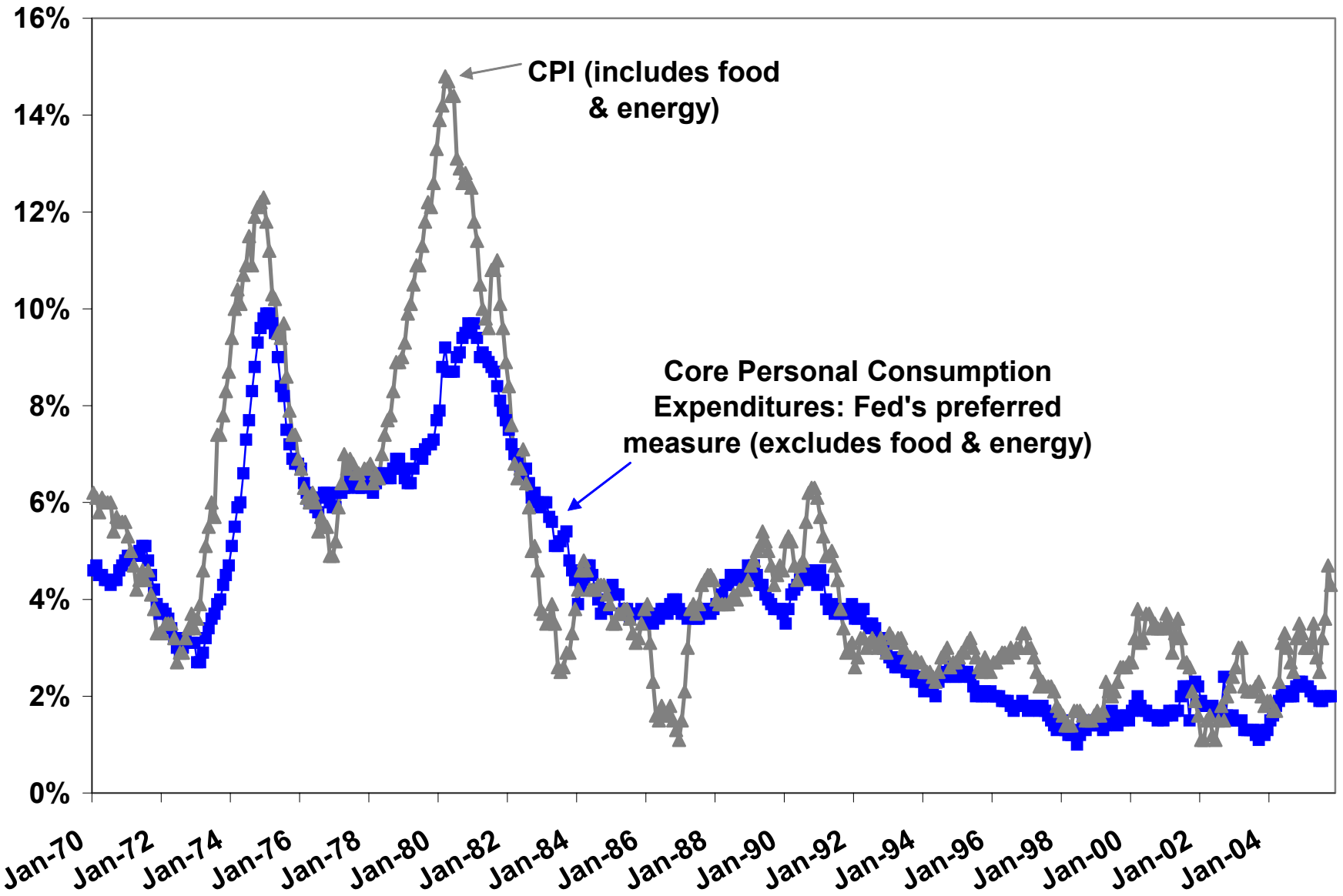
LONG TERM RATES ...GREENSPAN'S "CONUNDRUM"

- Indirect bidding (foreign purchases)
- Little job creation
- Global savings glut, chasing yield
- Inflation expectations still relatively low
- Fed cannot control long term rates

RECENT INFLATION DATA



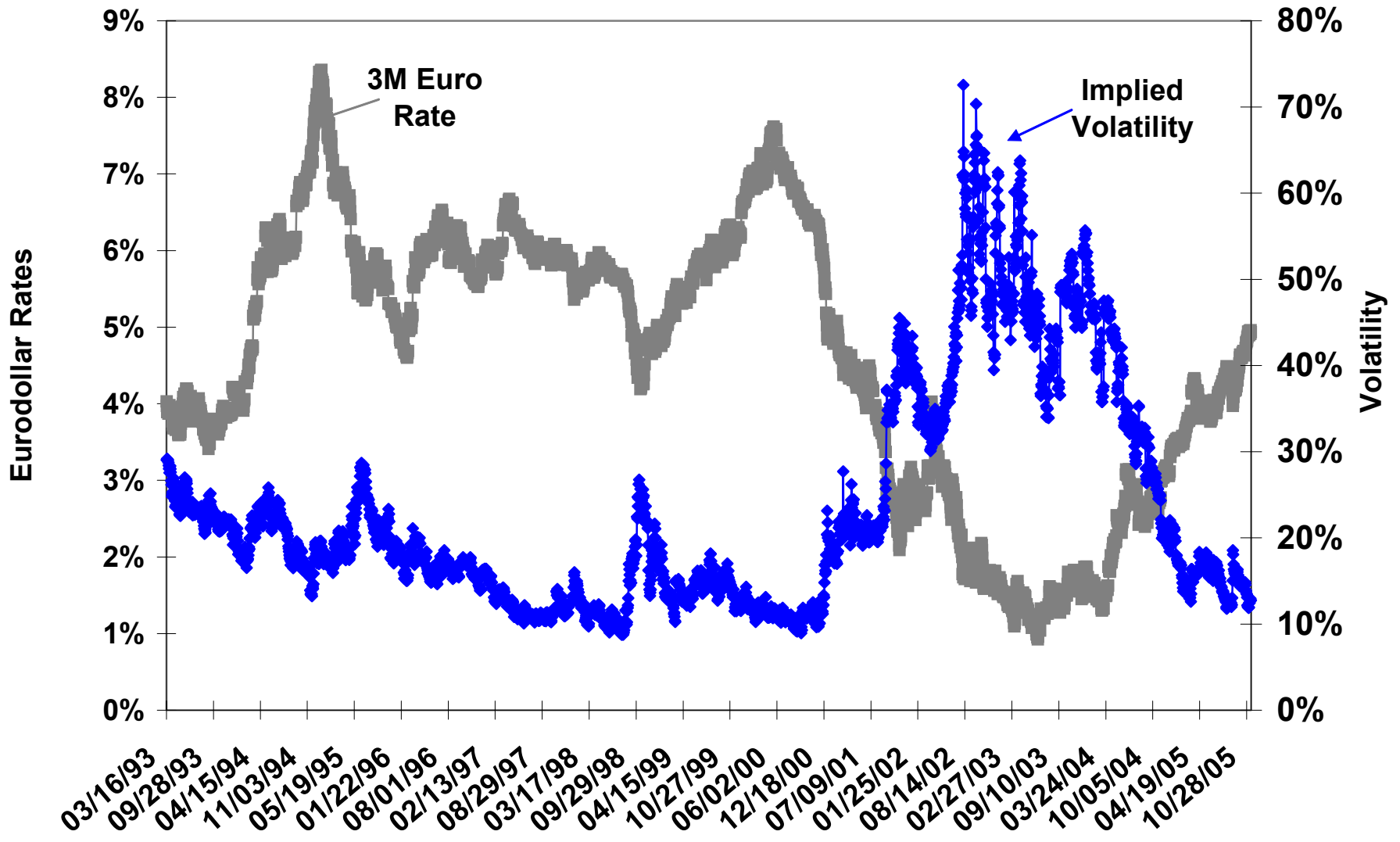
INFLATION DATA (FROM 1970)



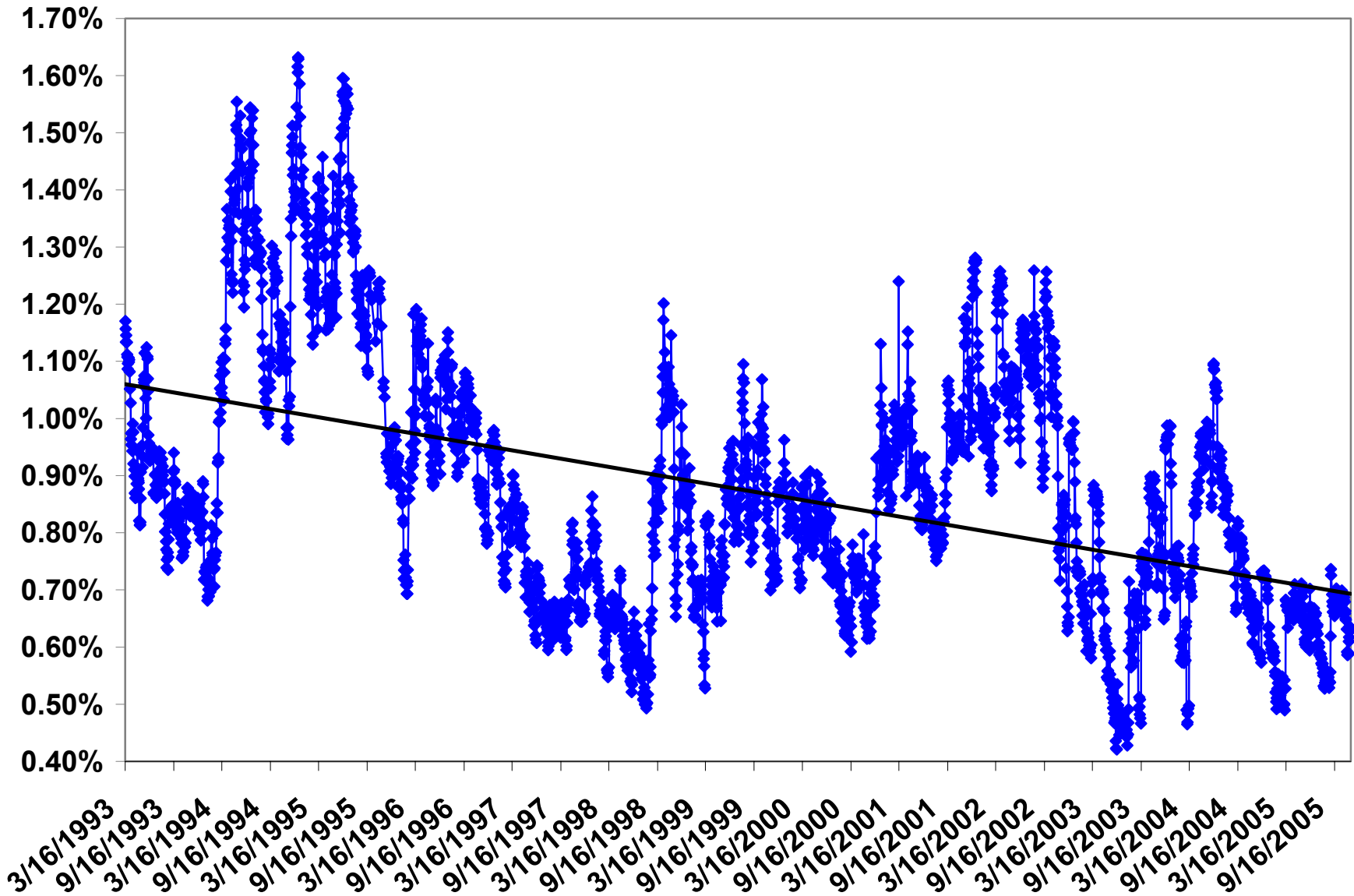
THE ERA OF LOW VOLATILITY..HERE TO STAY?

- Increased Fed transparency
- End of refinancing boom
- Natural volatility buyers (Fannie, Freddie) have smaller portfolios
- Low and stable yield environment
- Tight credit spreads

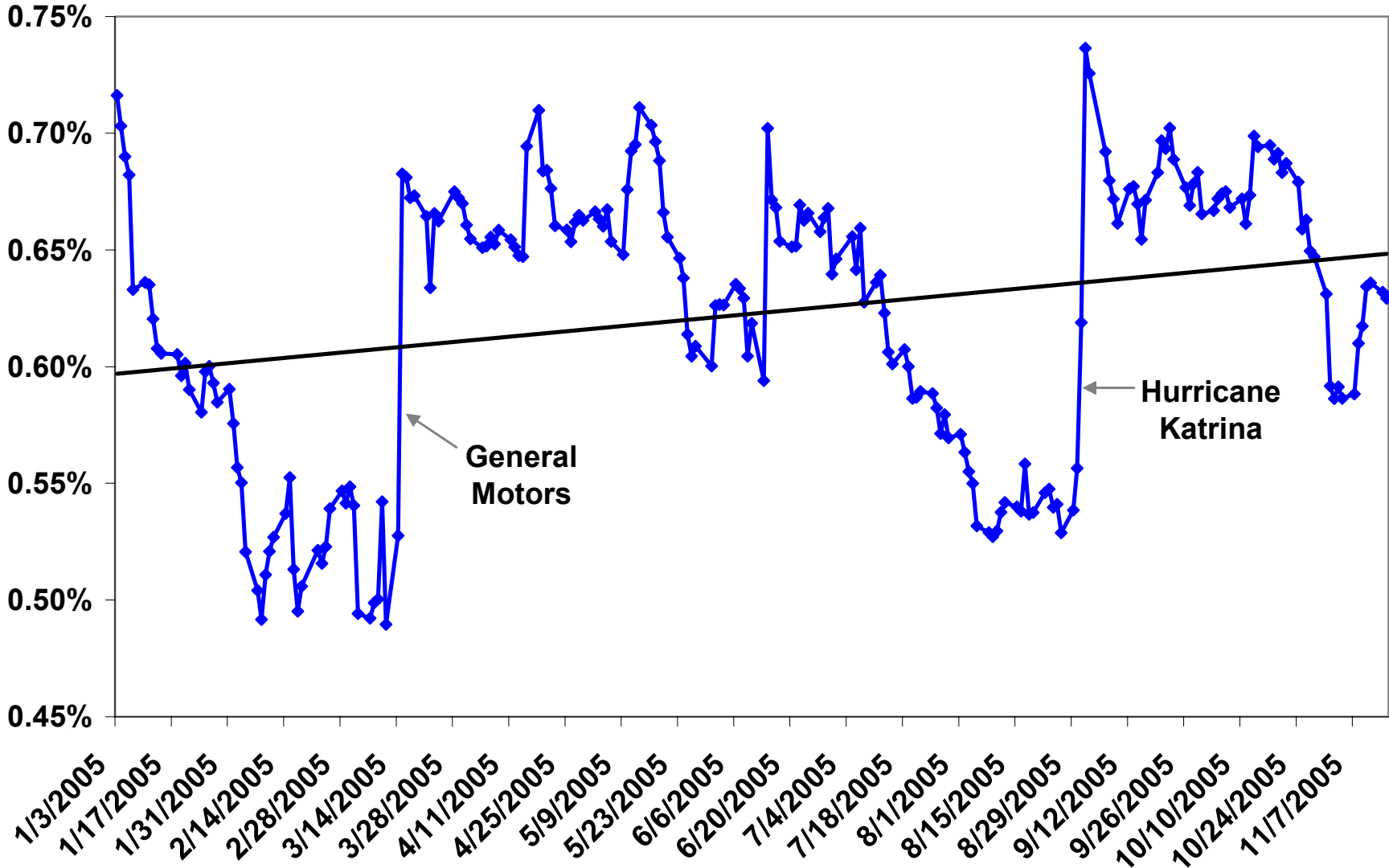
3 MONTH EURODOLLAR RATE (LEFT) VERSUS 3 MONTH EURODOLLAR IMPLIED VOLATILITY (RIGHT)



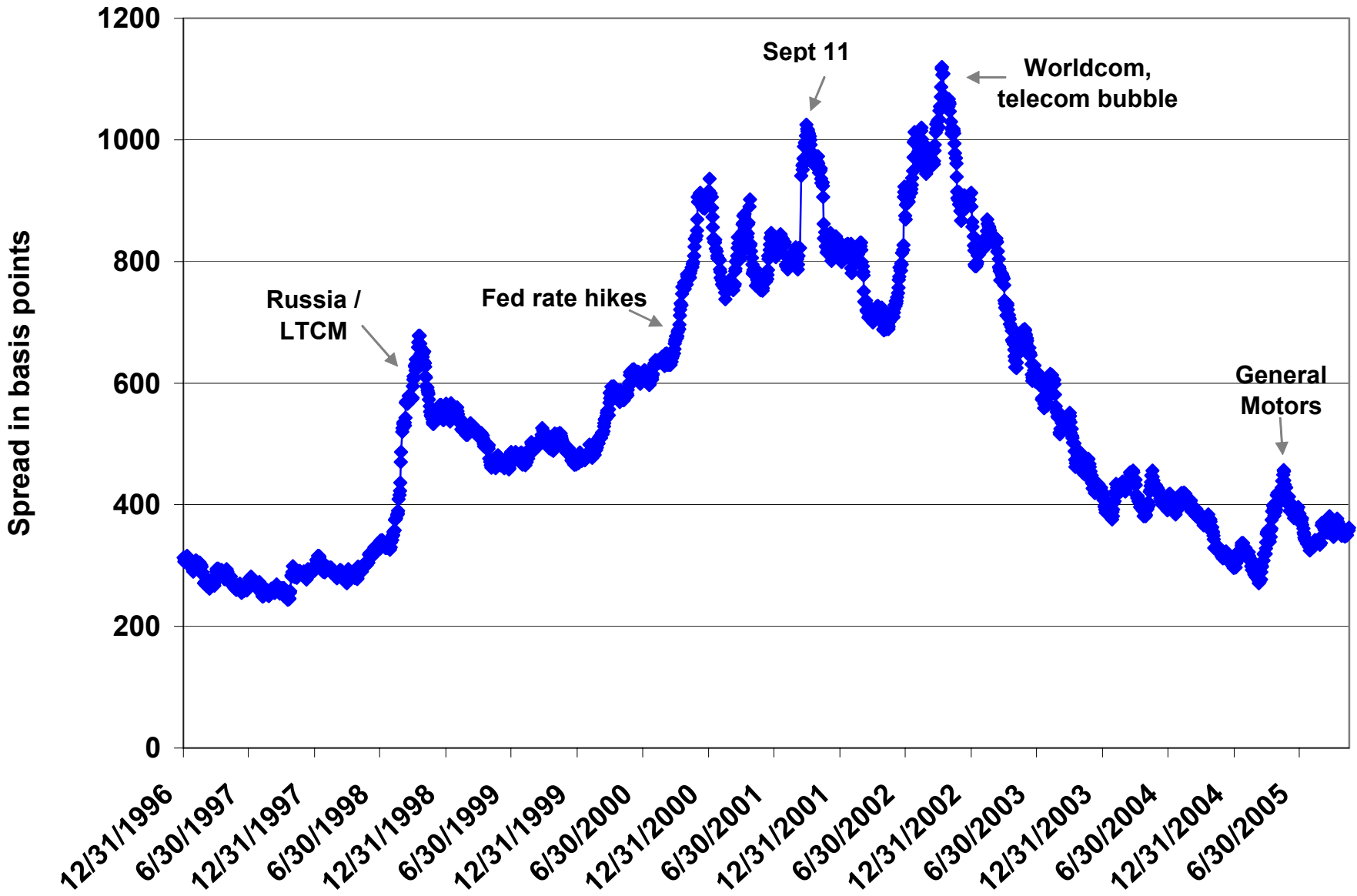
NORMALIZED VOLATILITY IN BPS (3 MONTH EURODOLLAR)



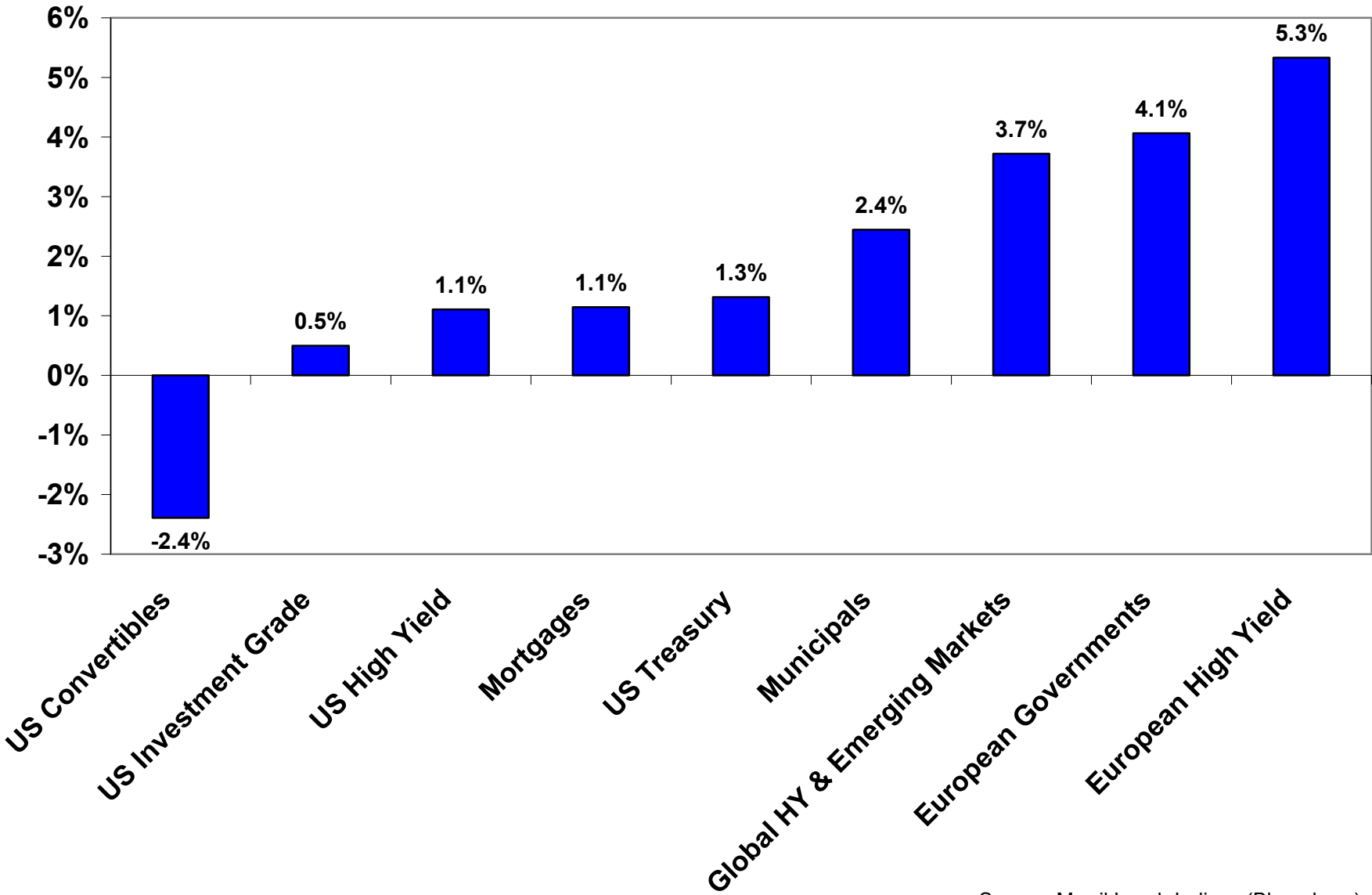
NORMALIZED VOLATILITY IN BPS (3 MONTH EURODOLLAR)



HIGH YIELD CREDIT SPREADS



2005 YEAR TO DATE RETURNS (THROUGH NOV 15, 2005)

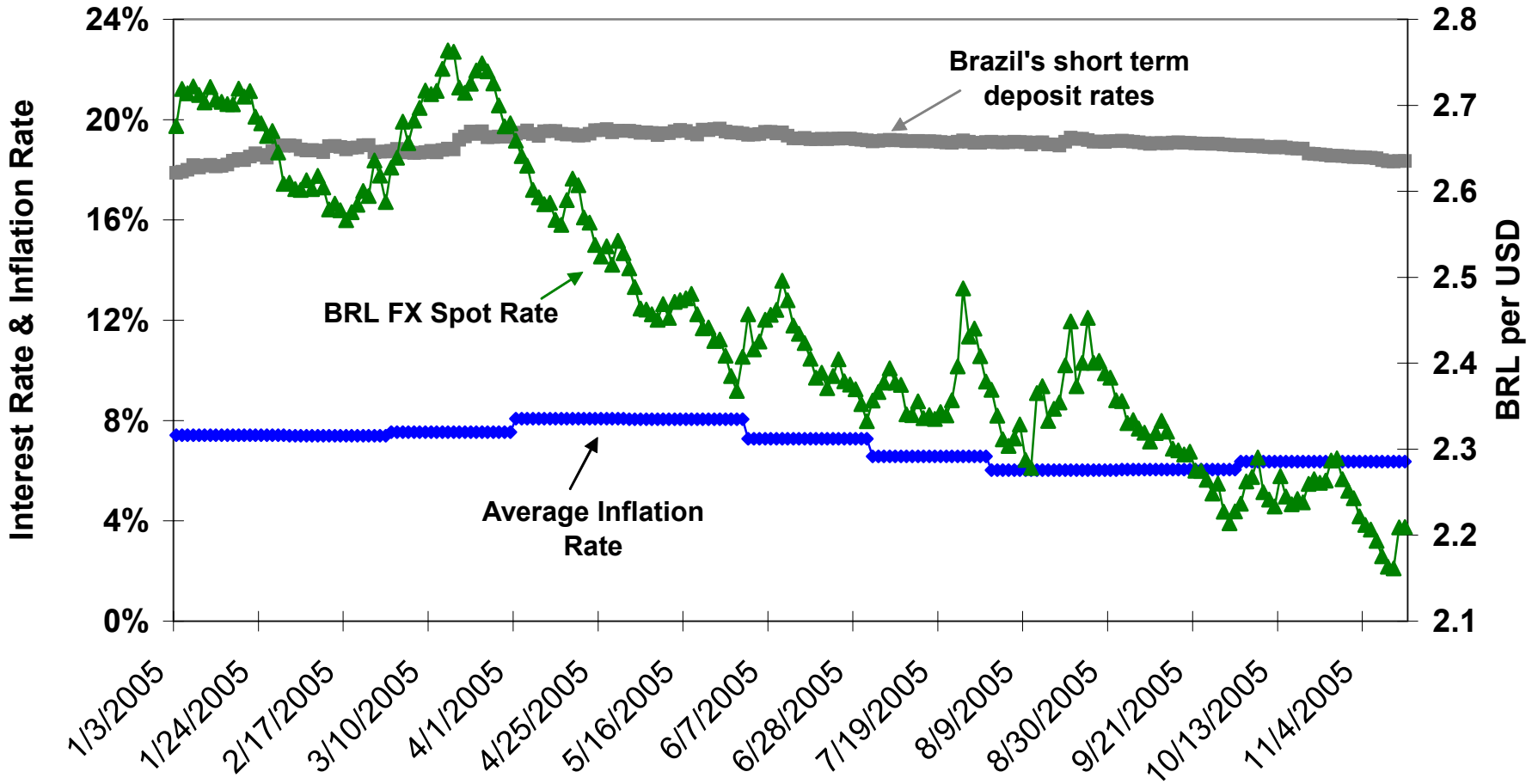


Source: Merrill Lynch Indices (Bloomberg)

HOME RUN: LONG BRAZIL

19% interest rate
 less 7% average inflation
 plus 17% currency appreciation

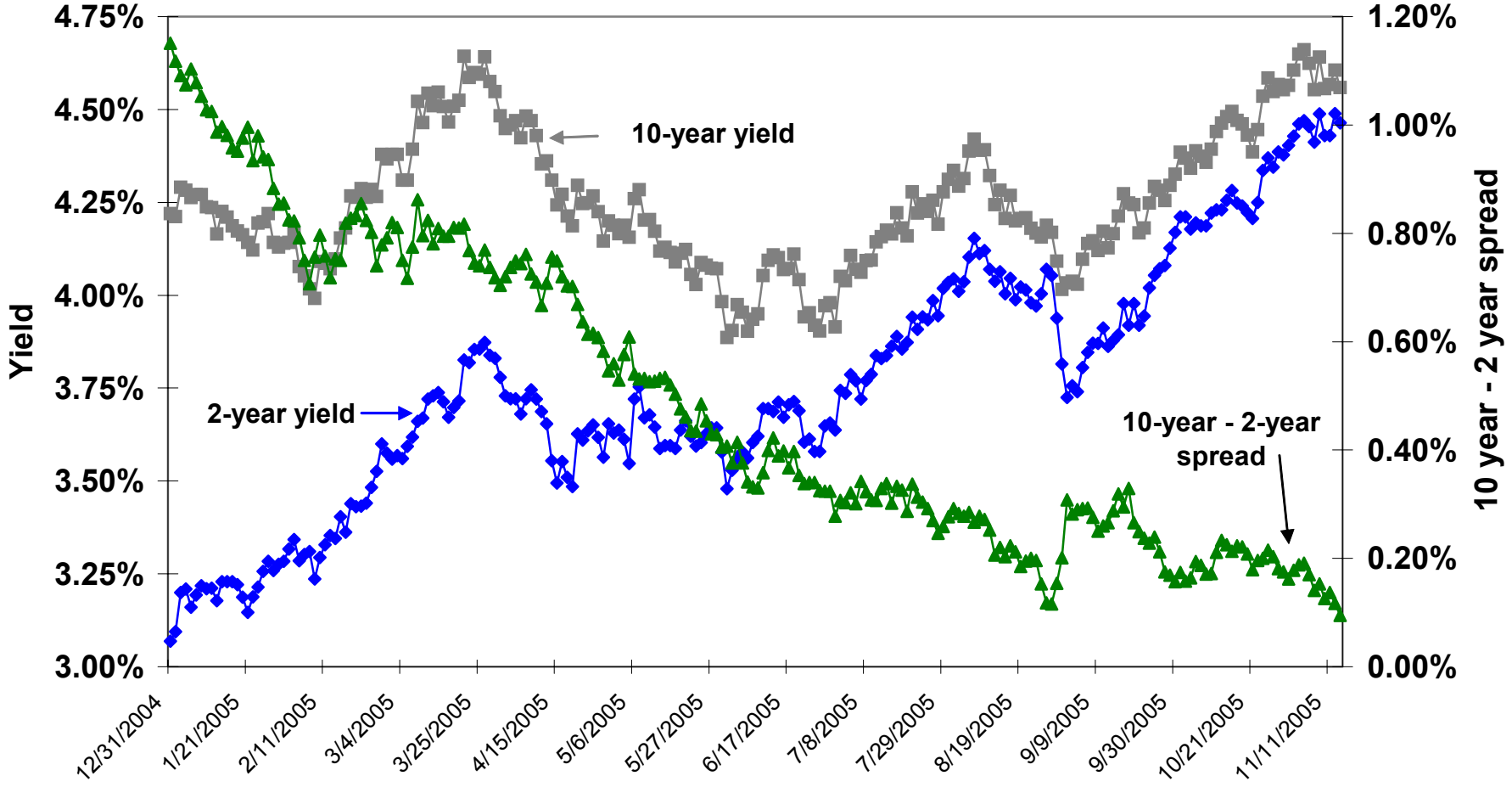
 29% unlevered real return



BASE HIT: 10 YEAR, 2 YEAR CURVE FLATTENER

Sell 2-year at 3.2%, fund at 2.25%
Buy 10-year at 4.2%, fund at 2.25%

1% unlevered net return + cap gains



- The case for a volatility *increase*
 - Continued rise in PCE inflation
 - Higher Interest Rate and Spread **levels**
 - Exogenous events
 - The end of the Greenspan “put” and the beginning of the Bernanke “?”
- Prediction: The waiting game continues