

April 2010

Portfolio Commentary

By Jill King, Vice President, Senior Portfolio Manager

April showers may not bring any May flowers this year...

April started the month on a solid note. Treasury yields rose in late March and were close to 2009 year end levels. A combination of stronger economic data and a huge auction of new supply offset the tame inflation indicators and the Fed's continued use of "extended period" of low rates language in their March 16th statement. Interestingly, the minutes from the March meeting focused more on "economic conditions" reporting that: "A number of members noted that the Committee's expectation for policy was explicitly contingent on the evolution of the economy rather than on a passage of any fixed amount of calendar time". The FOMC is now offering a different interpretation of the "extended period" language which lessens the impact of the statement. The FOMC has been consistent in moving only very, very gradually toward unwinding policy accommodation and we expect this cautious approach to continue. In fact, the Fed's statement after the April 28th meeting, again keeping rates in the 0 - .25% range, was almost identical to their statement in March. The Fed will look at the economic indicators to determine the appropriate time to begin to raise interest rates. The economic picture shows signs of improvement with two critical components, employment and housing, beginning to rebound. Also, retail sales and industrial production numbers were strong and indicate that the recovery is in place and there won't be a "double dip" of economic weakness. Any signs of economic improvement were met with bond market selling and rising yields. Although the US economy has made major strides toward recovery, concern regarding Sovereign risk, especially in Greece, could have a major impact on the US economy.

The economy took a back seat to breaking headlines as April progressed. The two top headlines were the SEC charging Goldman Sachs with fraud, and the subsequent criminal indictments, and the deterioration of the situation in Greece. All eyes were glued to the Congressional hearings that were held regarding Goldman Sach's involvement in the economic crisis of 2008 – 2009. As would be expected, Treasury yields rallied on both the major news stories.

The situation in Greece, and the other PIGS (Portugal, Ireland, Greece, Spain), escalated late in April and had a significant influence on LIBOR rates. 3-month Libor started April at .2915 and rose to almost .35 by month end. As I am writing this piece, 3-month Libor stands at .37359. This reflects the inability of European banks to borrow amongst each other and the deteriorating situation in the Euro Zone. On April 27th, S&P downgraded Greece from BBB+ to BB+, junk status. Portugal was downgraded from A+ to A-, and Spain was downgraded to AA from AA+. S&P maintains a negative bias on all 3 countries. The situation, especially with Greece, is very fluid as the bailout is negotiated between the IMF, the EU, and Germany. The new "sovereign" crisis has had a substantial affect on US markets with a return to the flight to quality trade. Treasury prices rallied across the curve, with the 2-year closing under 1%. We also experienced a rally in the USD versus most major currencies, and in particular versus the Euro Dollar.

The flight to quality and building global concern in the market has impacted the short end of the curve bringing down short rates. The increase in volatility, swap spreads and credit spread widening, made some products we purchase more attractive. Callable agencies levels have become interesting again. As of late, there was very little concession between callable and bullet agencies. Also, short dated corporates are trading with spread versus on top of treasuries.

May should be a very interesting month for the market and for the world. Keep your umbrellas out...the outlook is quite stormy.

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