

February 2010

Portfolio Commentary

By Amy Walkington Haney, Portfolio Manager

February proved to be an action packed month full of sovereign credit concerns, mixed economic data, and Federal Reserve announcements. The month began with credit concerns surrounding Greece's ability to handle their mounting deficit and quickly lead to worries of contagion to other European countries. Sovereign credit concerns sent investors flocking to the safety of U.S. Treasuries just as Treasury issued \$81 billion of 3, 10, and 30 year bonds. Unemployment unexpectedly fell to 9.7% in January coupled with the ISM Manufacturing's business barometer climbing to 62.6 (above 50 signals expansion). The index of U.S. leading indicators rose for the 10th straight month pointing to an expanding economy. On the other hand, sales of new homes in the U.S. fell to the lowest level on record and the Consumer Confidence reading of 46, the lowest level reported in the past 10 months, demonstrated the continued drag that housing and unemployment have on the consumer. The mixed economic data held yields in a tight range as investors continued to keep money short.

On February 18th, the Federal Reserve raised the discount rate by 25 basis points to .75%. Historically, the spread between the discount rate, the interest rate charged by the Fed to member banks borrowing from the Fed, and the Fed Funds rate, has been 100 basis points. The discount rate was cut during the financial crisis to encourage banks to use the discount window as needed without the negative stigma traditionally associated with tapping the Fed window. The Fed's move towards a normalized spread between Fed Funds and the discount rate did not come as a shock to the markets, as it was outlined by Chairman Bernanke as part of the Fed's exit strategy. However, the timing of the move, outside a Fed meeting, caught the market slightly off guard. Chairman Bernanke endeavored to separate traditional monetary policy from liquidity provisions put in place during the economic downturn. Mr. Bernanke emphasized that the hike in the discount rate was not a sign of monetary policy shift, but a move toward "normalization" of the Fed's lending facilities in light of the improving condition of financial markets. He also reiterated the "extended period" language regarding the current fed funds target rate of 0-0.25%.

Fannie Mae and Freddie Mac announced that they will purchase substantially all of the non-performing loans out of mortgage pools beginning in March. This amounts to approximately \$200 billion in mortgage debt 120+ days delinquent and will return or pre-pay \$200 billion to mortgage investors. The goal is to stimulate reinvestment of these proceeds into other mortgage backed securities. Most likely Fannie and Freddie will utilize their excess cash to fund the purchase of the delinquent mortgages effectively removing their excess reserves from the Fed funds market. This will put pressure on the effective rate which should increase overnight investment and repo levels.

The dynamics of the changing market have proven to be a challenge for even the most experienced managers. At Horizon, we have relied upon our 19 years of experience navigating the markets to determine the optimal mix of investment products and investment maturities. We continue to look for opportunities in the market while maintaining our philosophy of capital preservation.

Opinions expressed are those of Horizon Cash Management and are not intended to be a forecast of future events, a guarantee of future results or a recommendation. Horizon makes no assurance that securities discussed within will remain in or out of portfolios. Investing involves risk, including possible loss of principal.