

STIFEL NICOLAUS

Investment Strategies for a Challenging Market

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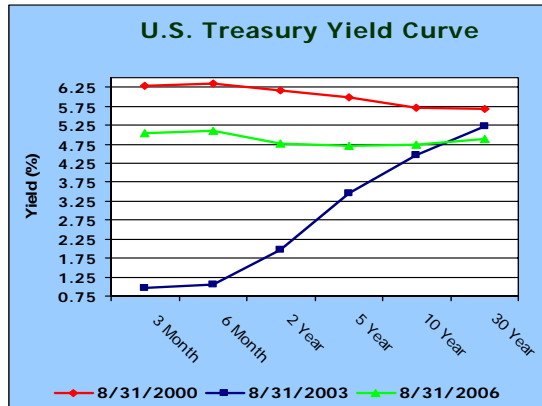
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Topics

- ❑ Assess current market conditions and outlook.
- ❑ Evaluate investment strategies under various yield curve scenarios.
- ❑ Identify cross-sector relative value opportunities.

Overview of Market Conditions

- ❑ The Fed's two-year+ tightening campaign raised fed funds by 425 bps, resulted in an inverted Treasury curve, and brought bond yields to their highest levels in five years.
- ❑ Through August, short-term bond index total returns were driven by yield. Price returns were negative due to higher rates and lack of meaningful contribution from spreads.



Source: Bloomberg.

Forward Rates Predict Lower Short-Term Yields and Steeper Curve

Treasury Yield Curve Analysis							
	Years to Maturity						
	1	2	3	4	5	7	10
Treasury Curve	5.01%	4.80%	4.73%	4.73%	4.72%	4.74%	4.77%
Yield Change Per Year	-0.24%	-0.21%	-0.07%	0.00%	-0.01%	-0.01%	+0.01%
Years Forward	Break-Even (Implied Forward) Rates						
1	4.59%	4.59%	4.63%	4.65%	4.68%	4.72%	4.76%
2	4.59%	4.66%	4.67%	4.70%	4.72%	4.76%	4.79%
3	4.72%	4.72%	4.74%	4.76%	4.77%	4.79%	4.82%
4	4.71%	4.75%	4.77%	4.78%	4.79%	4.81%	4.83%

Source: Bloomberg C18 screen as of 9/3/06.
Yield change for Year 1 measured relative to fed funds.

Yield Curve Scenarios and Portfolio Strategies

- **Inversion (short-term rates increase relative to long-term rates).**
 - **Strategy: short duration and barbell curve positioning.**
- **Bear Steepener (long-term rates increase relative to short-term rates).**
 - **Strategy: short duration and bullet curve positioning.**
- **Bull Steepener (short-term rates decrease relative to long-term rates).**
 - **Strategy: long duration and bullet curve positioning.**

Yield Curve Strategy Performance Analysis

Portfolio Characteristics

Portfolio	Duration	Yield (%)	Curve Positioning		
			0 - 1 Yr.	1 - 2 Yr.	2+ Yr.
Barbell 1	1.53	5.13%	50%	0%	50%
Barbell 2	2.44	5.11%	50%	0%	50%
Bullet 1	1.52	5.08%	0%	100%	0%
Bullet 2	2.48	5.04%	0%	100%	0%
Ladder	1.81	5.07%	33%	34%	33%
Lehman 1 - 3 Yr. Gov. Index	1.77	4.92%	3%	64%	33%

Source: Bloomberg and BondEdge as of 8/31/06

Representative portfolios were constructed using Agency benchmark bonds.

Projected Annual Total Returns

	Rate Scenario		
	Inversion	Bear Steep	Bull Steep
0 - 3 Month Yields	+75 bps	+25 bps	-125 bps
3 Year+ Yields	+25 bps	+125 bps	-75 bps
	Returns (%)		
Barbell 1	4.94%	3.63%	6.07%
Barbell 2	4.58%	2.58%	6.93%
Bullet 1	4.38%	4.08%	6.68%
Bullet 2	4.37%	2.34%	7.08%
Ladder	4.42%	3.46%	6.76%
Lehman 1 - 3 Yr. Gov. Index	4.19%	3.51%	6.64%

Yield curve scenarios are based on instantaneous shifts of the 8/31/06 Treasury curve. Yield curve points not shown were interpolated from the above changes.

Suggested Strategies

- ❑ Diversify yield curve exposure; avoid overloading the short duration bucket.
- ❑ To prepare for a steeper curve, focus on products in the intermediate sector of your permissible investment universe.
- ❑ Add incremental yield to the portfolio through short duration mortgage securities.
- ❑ Consider strategic swaps to upgrade the risk/reward profile of the portfolio.

Treasury/Agency – Relative Value

- ❑ Treasuries appear attractive for the front duration bucket, while Agencies offer better value further out on the yield curve.
 - ❑ Over the past 20 years, the 3-month Treasury yield has exceeded 2-year Treasury yield by more than 13 bps only 5% of the time.
 - ❑ At the end of August 2006, the yield spread between 2-year Agencies and 2-year Treasuries was near its widest level in five years.
- ❑ In the callable Agency sector, bonds with longer lockout periods and less frequent call schedules look favorable in a low volatility/flat yield curve environment.
- ❑ Discounted callables in the secondary market may provide a yield pick-up relative to bullets with similar final maturities.

Short Duration Mortgages – Relative Value

- ❑ If permissible by investment policy, mortgage securities should be considered to diversify the portfolio, enhance income, and improve total return performance .
- ❑ Representative offerings in the 0-3 year duration sector:

Security Type	WAL	Maturity	Yield	Spread to Treasury Curve
6% Balloon Mortgage Pass Through	1.4yr	Aug-08	5.41%	+50bps
FHLB Indexed Amortizing Note	3.6yr	Jul-11	5.21%	+49bps
Sequential Pay/Mandatory Redemption CMO	2.9yr	Dec-13	5.43%	+70bps

Source: Stifel Nicolaus Fixed Income Trading Desk as of 09/08/2006.



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