

FIXED INCOME MARKET UPDATE
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FIXED INCOME MARKET UPDATE

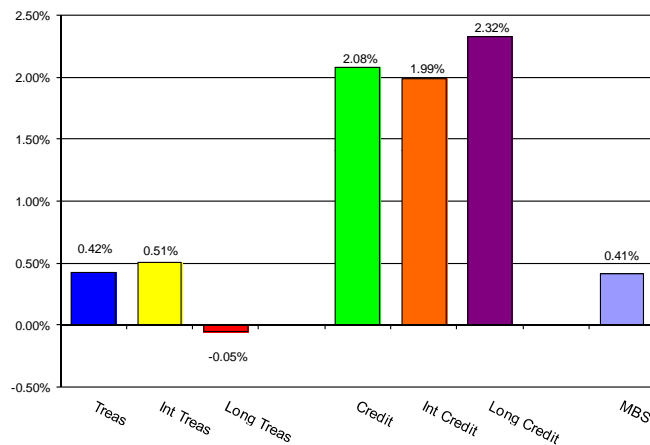
- For the month ended January 31, 2012, the Barclays Capital Aggregate Bond Index (BCAGG) returned +0.88%.
- U.S. Treasuries (+0.42%) realized positive returns during the month following the Fed's announcement that the outlook for U.S. economic activity would "warrant exceptionally low levels for the federal funds rate at least through late 2014." As a result of this shift in the expected timing of a change in interest rate policy, rates on the short end of the yield curve declined and the yield on 5-year Treasuries reached a new all-time low (0.705%) helping intermediate Treasuries (+0.51%) outperform long Treasuries (-0.05%) by 56 basis points.
- Mortgage-backed securities (+0.41%) outperformed duration-matched Treasuries by 13 basis points during the month as the option-adjusted spread (OAS) of the Barclays Capital U.S. Mortgage index tightened 2 basis points to end the month at 73 basis points. Mortgage returns were muted during the month as the President noted in his State of the Union address an outline for a potential streamlined refinancing program. In addition, the administration announced further enhancements to the current HAMP program which significantly broadened the pool of applicants that would be eligible for mortgage modifications in addition to extending the program's maturity date to December, 2013 from December, 2012.

FIXED INCOME MARKET UPDATE (continued)

- Credit securities (+2.08%) were the best performing sector of the fixed income marketplace realizing 165 basis points of excess return as the option-adjusted spread (OAS) of the Barclays Capital U.S. Credit Index tightened 26 basis points to end the month at 191. Despite underperformance on the long end of the Treasury curve, long credit (+2.32%) outperformed intermediate credit (+1.99%) on both an absolute and a duration-adjusted basis as the effect of spread tightening was more pronounced in longer duration securities.
- Financials (+3.66%) were the best performing credit subsector during the month, outperforming utilities (+1.15%), industrials (+1.58%) and non-corporates (+1.58%) by 245, 206 and 203 basis points of excess return, respectively. Financials began 2012 with significant outperformance following a weak 2011.
- Lower quality investment grade securities outperformed during the month. A rated securities were the best performing quality bucket, in part due their exposure to financials. BBB, A, AA and AAA rated securities realized 164, 198, 131 and 74 basis points of excess return, respectively.

SECTOR, QUALITY & TERM STRUCTURE RETURNS FOR THE MONTH ENDED JANUARY 31, 2012

U.S. Fixed Income Sector and Term Structure Returns

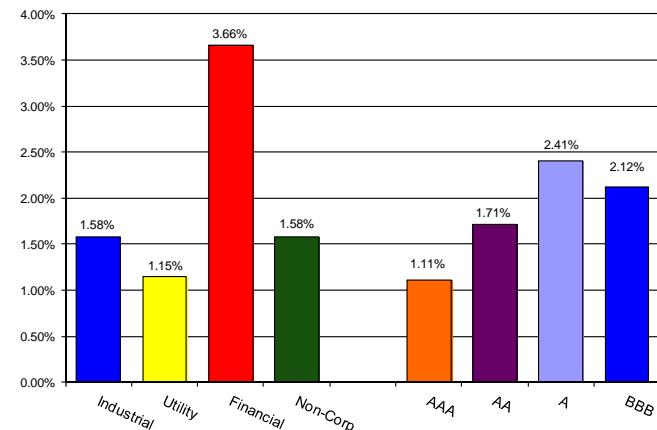


Financials were the best performing credit subsector as European markets improved and the U.S. Government extended initiatives to improve the housing market. A rated securities outperformed due to exposure to financial issuers.



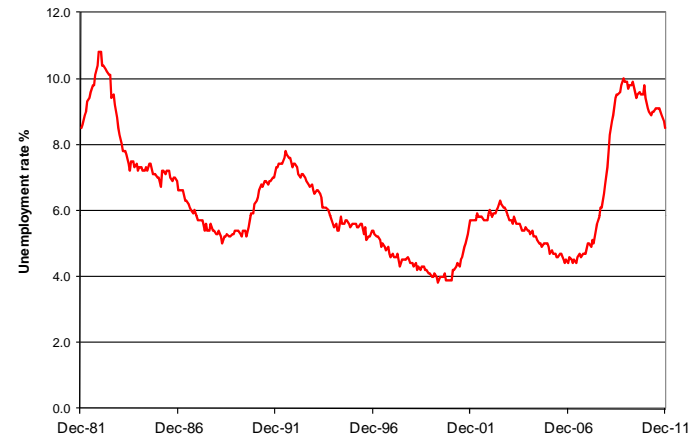
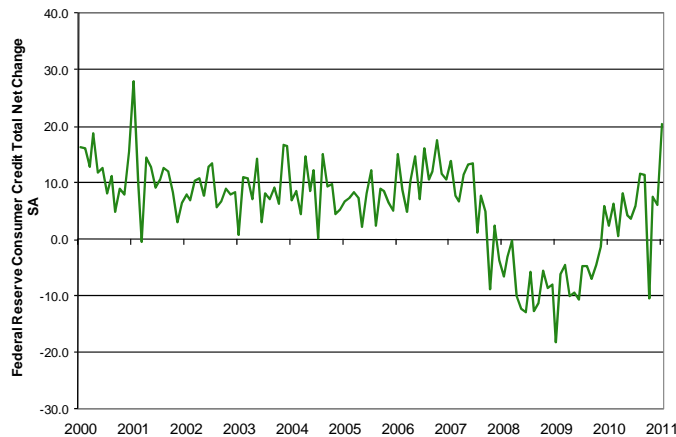
Credit securities outperformed during the month as spreads compressed and investors reached for yield in the low interest rate environment. Long Treasuries realized negative returns despite a Federal Reserve commitment to continue an accommodative monetary policy longer than previously expected.

U.S. Credit Subsector and Quality Returns



UPDATE ON THE U.S. ECONOMY

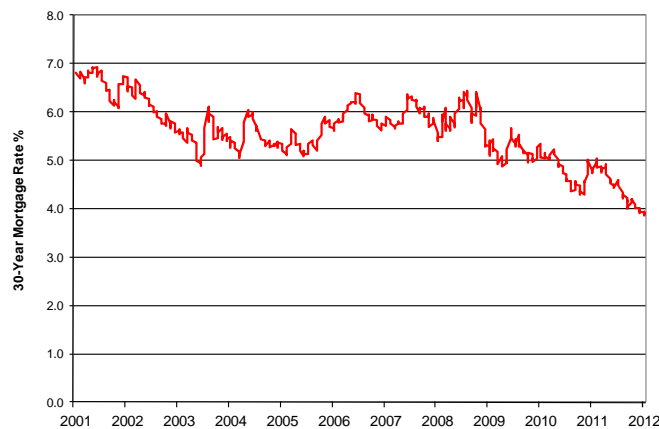
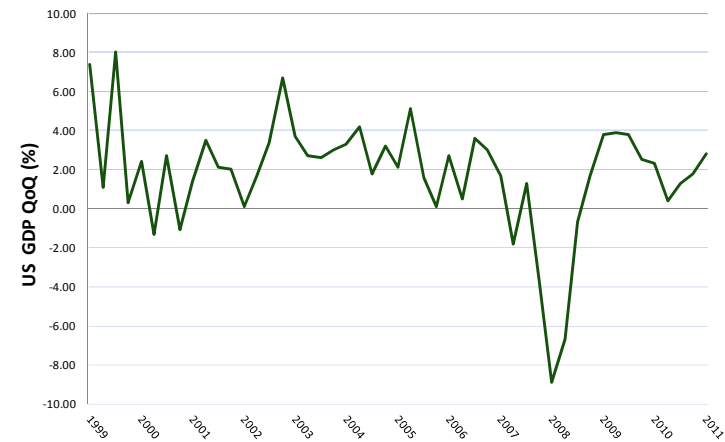
Led by hiring within transportation, warehousing, retail, manufacturing, health care, and mining, the Bureau of Labor Statistics reported that nonfarm payroll employment increased by 200,000 in December, as the unemployment rate decreased 0.2% to 8.5%, its lowest reading since April, 2009.



Data released by the Federal Reserve showed that consumer credit increased \$20.4 billion during the November month, the largest monthly increase in a decade. According to the report, non-revolving forms of credit—such as automotive and educational loans—accounted for \$14.8 billion of new borrowings.

UPDATE ON THE U.S. ECONOMY (continued)

Economic activity accelerated moderately during the fourth quarter as GDP growth increased to 2.8% compared to 1.8% in the third quarter, and below the median market estimate of 3.1%. The report was disappointing as inventories accounted for 1.94% of overall growth. Ex-inventories, the headline number was an anemic 0.86%.



The interest rate on 30-year mortgages reached record low levels during the January month, falling as low as 3.85% as mixed economic and consumer data once again left investors weighing the possibility of another round of Quantitative Easing (“QE 3”).

ECONOMIC AND MARKET OUTLOOK

Following the conclusion of its January meeting, the Federal Open Market Committee (FOMC) expressed concern that a slowdown in business fixed investment and lower than anticipated capacity utilization will result in only gradual declines in the unemployment rate. In response, the Fed extended its outlook for, “exceptionally low levels for the federal funds rate at least through late 2014.” Notably, throughout the current Committee’s tenure, policy directives have only referenced the Federal Reserve’s dual mandate of maximum employment and stable prices; however, in a subsequent release hours after the initial statement, the FOMC issued a firm commitment to its “statutory mandate from the Congress,” which includes, “moderate long-term interest rates,” adding a third dimension to its mandate. Despite this language appearing in the Fed’s charter, this is the first mention of the interest rate component in a directive released by this Committee.

The FOMC also provided its much-anticipated commentary in conjunction with its commitment of increased transparency. According to the Fed, “clarity facilitates well-informed decision making by households and businesses, reduces economic and financial uncertainty, increases the effectiveness of monetary policy, and enhances transparency and accountability.” In order to explain its monetary policy decision to the public, “as clearly as possible,” the Committee for the first time quantified general levels for key economic indicators it views as consistent with its statutory mandate over the longer run, e.g. “inflation at the rate of 2%, as measured by the annual change in the price index for personal consumption expenditures.” The Committee also noted that the normal rate of unemployment currently holds, “a central tendency of 5.2% to 6.0%,” but is subject to significant revisions, and therefore will change over time with their expectations for longer run normal rates of output growth.

On January 31, the Congressional Budget Office (CBO) issued a report in which the non-partisan group stated the 2012 U.S. budget deficit would rise to \$1.079 trillion from its previous estimate of \$973 billion made last August. With this revision, the United States is on track for a fourth straight year with a budget deficit exceeding \$1 trillion, as a tepid economic recovery continues to weigh down tax revenues. Elsewhere in the report, the congressional forecasters warned that an extension of payroll tax cuts would further increase the deficit.

ECONOMIC AND MARKET OUTLOOK (continued)

Volatility surrounding concerns about the health of European economies, the solvency of their financial institutions and pressure on the sovereign debt ratings continued in January. On January 13th, Standard & Poor's downgraded the AAA ratings of Austria and France, leaving Germany as the only Eurozone member carrying the agency's highest rating with a stable outlook. In the same release, the agency also lowered the ratings of Italy and Spain to BBB+ and A, respectively, while Portugal saw its debt rating cut two notches to BB and is now carrying a high yield rating by all three agencies. The rating agency added, "the policy initiatives that have been taken by European policy makers in recent weeks may be insufficient to fully address ongoing systemic stresses in the Eurozone." Further, the renewed disagreement between Greece and its creditors is of particular concern; according to the negotiators, if the two parties do not reach an agreement on the country's debt, Greece will not secure the €130 billion in bailout funds, possibly resulting in a disorderly default in March.

Looking forward, we expect spread product to continue to outperform. We believe the actions taken by the Federal Reserve and monetary authorities around the world will, in effect, help to improve the economic outlook of the global economy. This improving economic activity as well as the low interest rate environment overall will encourage investment in risk assets and thus bode well for corporate spreads.

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