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Fixed Income Market Comments

Alas, another quarter came and went without action by the Federal Reserve. Unfortunately, the Fed's lack of movement was overshadowed by the mid-quarter devaluation of the Chinese yuan. The biggest event of the third quarter, the devaluation and subsequent market crash heightened fears of the already opaque Chinese economy. It became clear that the country's growth targets were fiction, with predictable secondary effects on China's major trading partners, especially in the emerging markets. Surprisingly, emerging and international market weakness seemed to be the main complaint of the Fed when they decided not to raise rates. An institution obligated to target US employment and US inflation suddenly became very internationally focused. And since US inflation is pretty much nonexistent and employment is arguably at the Fed's target, throwing international disquiet into the whole "data dependent" mix sent a confusing signal to the markets. Added to the volatility created by China, stocks experienced their worst quarter in four years as the S&P 500 was down 6.9%. Oil prices fell over 33% in July and August before recovering some losses, ending the quarter down 20.8%. Equity volatility spiked in the third quarter as global growth downgrades left investors worried that central bank accommodation could not cure the ills of prolonged disinflation and emerging market currency weakness.

It seems the Fed's "data dependent" timetable for raising rates continues to be a moving target. This is not the Fed we knew under Bernanke, who preached open and clear communication. One fear is if the Fed doesn't raise rates by December, it may lose the effect of the increase altogether. Markets may simply discount the Fed's moves or react in ways contrary to policy changes. Some are arguing chairwoman Yellen is keeping interest rates low to temporarily push unemployment below its long-run natural rate to entice discouraged workers back into the labor force, expand full-time employment, and boost wages. However, critics say this could cause inflation to surge in the long-term. The jobless rate is at 5.1 percent, just above the 4.9 percent that Fed officials consider full employment. However, the participation rate, the share of working-age people employed or actively looking for a job, dropped to 62.4 percent in September, the lowest since 1977. Some economists believe the amount of discouraged workers who are not accounted for in the 5.1 percent jobless rate is keeping that number artificially low. This could account for Yellen's attempt to draw those workers back into the mix.

To be candid, the third quarter has been a volatile time in both equity and fixed income markets. Yields fell as there was a flight to quality and remain low as investors wait for the storm to pass. While we don't believe this is anything other than a market correction, it can be concerning to watch, and being invested in quality investments has truly paid off. High quality investment grade bonds typically do well in times of equity downturns, and this has been no exception. It's another important lesson in the value of diversification within a portfolio.

Taxable Fixed Income Performance Composite

The TCVA taxable fixed income composite continues to outperform its benchmark for the quarter and for the year. The composite maintains an average weighted maturity and duration shorter than the benchmark, as well as higher credit quality. Maintaining a high yield continues to be a challenge in the current interest rate environment, however we are still finding the most value in the Taxable Municipal bond market. In the current interest environment and the hope that the Fed will finally make a move in December, we believe that a fixed income portfolio with short to intermediate durations remains the best strategy.

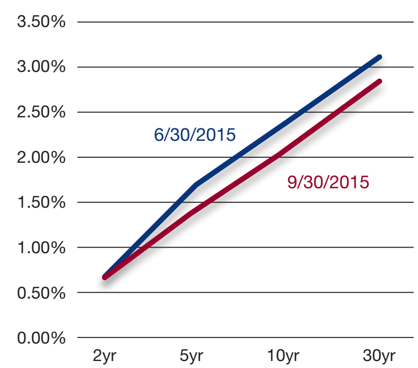
Portfolio Characteristics:

Average Maturity	3.8 yrs
Average Duration	3.4 yrs
Average Yield to Maturity	2.39%
Average Coupon	4.33%
Average Quality	AA-

Credit Quality:

AAA	10%
AA	49%
A	32%
BBB	9%

Treasury Yield Curve



Fixed Income Sector Breakdown