

Philosophy

Boyd Watterson is committed to pursuing fixed income results in excess of our benchmarks through active portfolio management. The foundation of our investment philosophy is based on fundamental economic and credit research conducted by highly experienced investment professionals. It is our belief that above-average returns can be achieved through duration management, exploiting changes in spread relationships and identifying undervalued sectors and securities while maintaining a high quality, liquid portfolio. The duration decision is based on a two-step process. First, the strategy assumptions create a bias with respect to relative duration management. Second, quantitative interest rate models provide analysis into the direction of interest rates. The strategy team reconciles the biases into a specific duration target. The resulting portfolio duration will range between +/- 25% of the prescribed benchmark, unless otherwise specified by the client. Our yield curve strategy is to manage the yield curve distribution vs. the index within the context of our duration strategy. The eligible securities may include investment grade and high yield, both domestic and international, rated B- or B3 at the time of purchase.

Process

Consistent examination of historical spread relationships is imperative in the sector allocation process. Identification of changing dynamics in the marketplace, which may lead to permanent or aberrant behavior between sectors, is also important. The underlying strategy assumptions normally lead to biases with regard to sector allocation. Historical spread relationships are then referenced to clarify and enhance the specifics of the sector allocation decision. We design the portfolios for the Ultra Enhanced Core product by building on core portfolio holdings such as treasuries, agencies and investment grade corporate bonds, then investing up to a 30% weighting of below investment grade securities. Security selection is facilitated by an examination of credit quality. A combination of internally and externally generated research is used in support of a given credit outlook. This process seeks to analyze credit quality in the context of actual security valuation. Credit-sensitive issues are concentrated in short and intermediate maturities.

Profile

The Fixed Income Strategy Committee consists of four voting members. This team formulates a model portfolio for each product versus the appropriate benchmark. Each portfolio manager holds responsibility for a group of individual portfolios and is responsible for their adherence to the appropriate model. This process is designed to ensure consistency across all portfolios and to lower transaction costs by maximizing economies of scale. The process also helps facilitate efficient interaction with the broker/dealer community.

Composite Summary

Composite Assets	\$458.0 million
Composite Accounts	28
Strategy Assets	\$1.1 billion
Strategy Accounts	318
Benchmark	Barclays Capital Aggregate

Quality / Maturity

High			
Med			
Low			
	Short	Int	Long

Portfolio Composition

	Composite*	Benchmark**
Average Duration	4.86 Years	4.94 Years
Average Maturity	6.05 Years	6.75 Years
Average Coupon	4.97%	3.88%
Average Yield to Maturity	2.88%	2.11%
Average Quality	A1	Aa1

Sector Allocation

	Composite*	Benchmark**
Treasuries	22%	36%
Agencies	2	7
Mortgage Backed	30	30
Corporate	22	21
Municipal	-	-
High Yield	21	-
CMBS	3	2
ABS	-	-
Other	1	4

Quality Allocation

	Composite*	Benchmark**
Aaa	58%	76%
Aa	3	4
A	8	11
Baa	11	9
Below Baa	21	-

Maturity Allocation

	Composite*	Benchmark**
0 - 1	4%	- %
1 - 3	26	24
3 - 5	33	40
5 - 10	30	23
10 - 15	-	1
15 - 20	1	2
Over 20	6	9

* Based on the model portfolio.

** Source: Capital Management Sciences.