

5 to 10-year Treasury yields are up nearly 1% since early November

Q. Is the back-up in interest rates technical or fundamental?

A. Fundamental

- While some of the early move higher may have been due to diminishing expectations for additional QE2 easing, we believe most of the recent rate rise is fundamental
- The outlook for 2011 economic growth has improved significantly in recent months
- The White House tax compromise adds roughly \$210 billion in incremental fiscal stimulus to the economy
- Consumer spending is exceeding expectations and likely to improve in 2011
- The removal of uncertainty regarding the elections and tax policy will improve confidence and business investment

Q. Does this signal a new up-trend in interest rates?

A. No

- While a further move higher in rates is not out of the question, a trend reversal is unlikely
- The Fed is committed to QE2 and is likely to complete their \$600 billion in Treasury purchases plus mortgage holding reinvestment through June 2011
- Inflation remains well contained over the short to intermediate term
 - Massive global excess capacity will restrict price increases
 - Unit labor costs are low due to productivity improvement and limited wage gains
- The long-term outlook for inflation remains dependent on both monetary and fiscal policy decisions

Take advantage of improved yields and maintain benchmark duration, biased toward curve flattening in the year ahead. Continue to favor spread products.



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