



# Crossover Strategy: Investing in Taxable and Municipal Bonds

July 2011

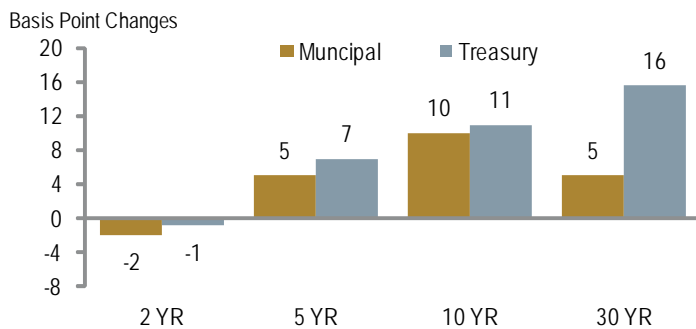
## Executive Summary

- Risk aversion rose in the taxable bond market but has not spread to the municipal market.
- Municipal returns benefited from continued improvement in sentiment, light new issuance and heavy reinvestment demand.
- Spreads in revenue bonds remain wide, reflecting less retail demand in the absence of bond insurance.
- Taxable spread sectors have been pressured by the increased volatility in Europe.

## Sector Returns

Bond yields fell for much of June amid a flight to quality but reversed course at month-end on market relief with ECB approval for Greece's funding package.

### Yield Changes



Source: Barclays, TM 3 as of 6/30/11

Corporate bonds lagged Treasuries as investors reigned in risk. Strong demand and low supply drove the outperformance in the municipal sector.

### Barclays Index Returns as of 6/30/11

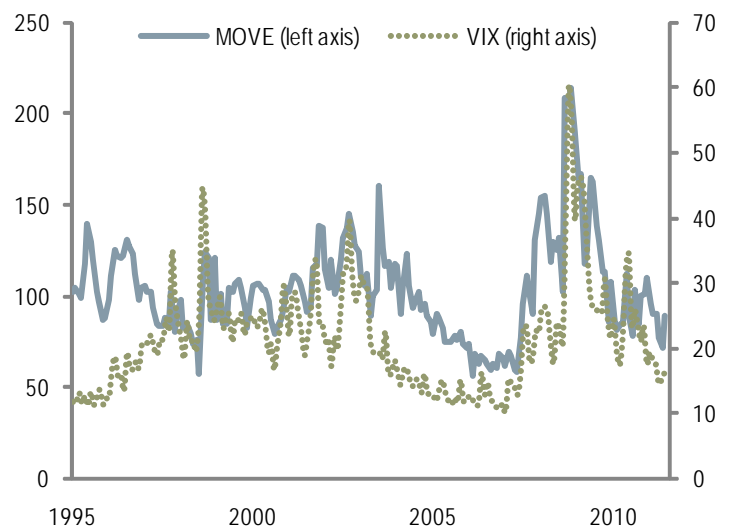
	Jun	YTD	Duration
Treasury 5 Year	-0.04	2.94	4.88
MBS	-0.03	2.10	4.66
Corporate 5 Year	-0.55	2.93	4.34
Muni 5 Year	0.22	3.18	3.84
Muni 5 Year GO	0.18	3.26	3.84
Muni 5 Year Revenue	0.27	3.19	3.84

\*Taxable bond returns netted down using 35% tax rate  
 Source: Barclays, Thompson Reuters as of 6/30/11

## Market Environment

Market volatility has picked up in the flight to quality and is reflected in weaker taxable bond performance.

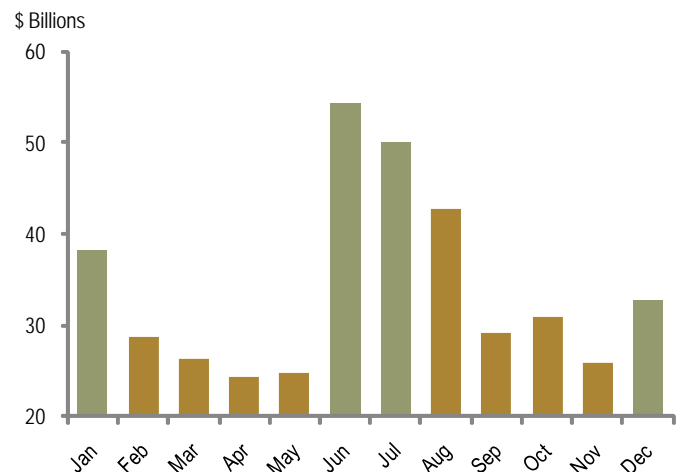
### Equity and Bond Market Volatility



Source: Bloomberg as of 6/30/11

June, July and August are traditionally strong months for reinvestment in municipal bonds and have been positive for sector returns.

### Municipal Reinvestment - Redemptions & Coupon



Source: Barclays Capital

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## Relative Value

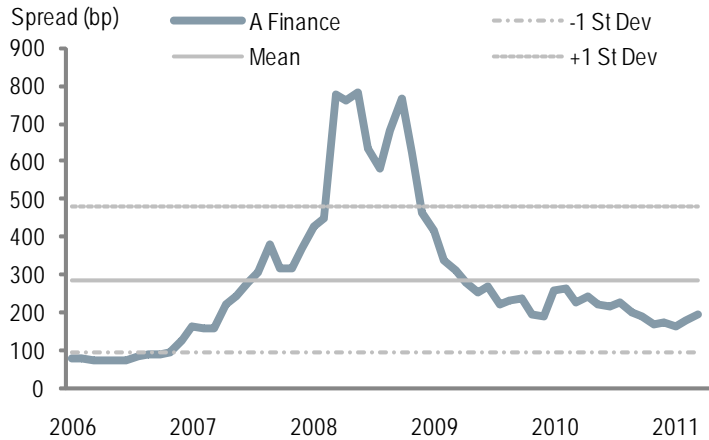
AAA general obligations have attractive yields versus low yielding Treasuries.

Yield Ratio: AAA Muni GO/Treasury				
	2 Yr	5 Yr	10 Yr	30 Yr
AAA GO Muni	0.40	1.20	2.66	4.30
Treasury	0.37	1.46	2.91	4.19
<b>Current Ratio</b>	<b>108.4%</b>	<b>81.9%</b>	<b>91.5%</b>	<b>102.6%</b>
90 Day Average	96.8%	75.4%	87.6%	102.1%
1 Year Average	98.7%	83.6%	91.1%	102.1%
5 Year Average	95.3%	87.5%	91.0%	101.8%

Source: Bloomberg, Barclays as of 7/12/11

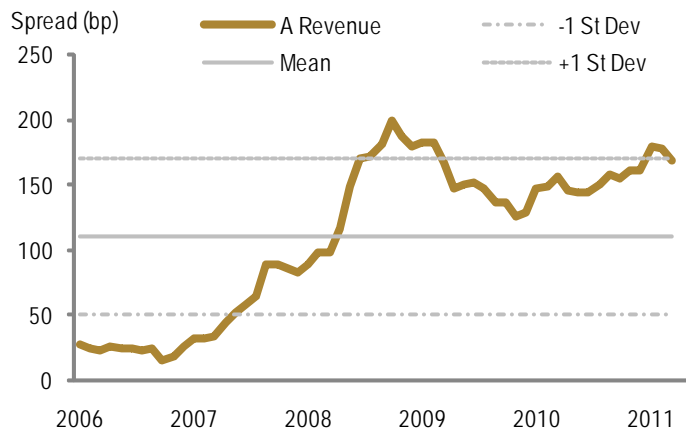
Corporate spread widening, despite strong credit fundamentals, contrasts with tighter municipal bonds spreads.

## A Corporate Financial Yield Spread



Source: Barclays as of 6/30/11

## A Muni Revenue Yield Spread

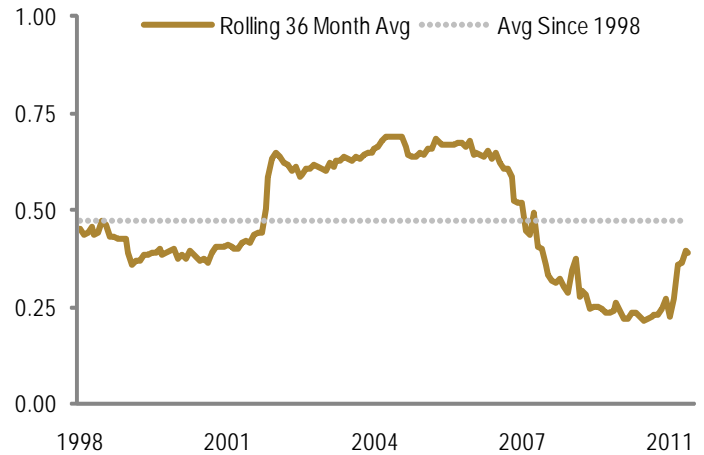


Source: Barclays as of 6/30/11

## Opportunities

Municipal bonds continue to demonstrate a low beta relative to taxable bonds, which should favor municipal bonds during periods of rising rates.

## 5 Year AAA Muni GO/Treasury Yield Correlation



Source: Barclays as of 6/30/11

We believe yields on municipal revenue bonds remain attractive versus corporate bonds and agency MBS.

## Tax Adjusted Yields

	2 Yr	5 Yr	10 Yr	30 Yr
US Treasury	0.30	1.14	2.05	2.85
Pre-refunded	0.47	1.21	-	-
Fixed Rate MBS	-	2.32	-	-
AAA GO	0.40	1.21	2.61	4.12
AA GO	0.46	1.38	2.83	4.30
A Revenue	1.23	2.31	3.32	5.51
A Financial	1.34	2.40	3.19	4.09
BBB Industrial	1.12	2.09	3.05	3.98

\*Taxable bond yields netted down using 35% tax rate

Source: Barclays, Thompson Reuters as of 6/30/11

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*Barclays Capital U.S. Treasury 5 Year Index is an unmanaged index of public obligations of the U.S. Treasury with a remaining maturity of 4 to 6 years.*

*Barclays Capital U.S. Mortgage-Backed Securities Index is an unmanaged index of 15- and 30- year fixed rate securities backed by mortgage pools of Ginnie Mae, Freddie Mac and Fannie Mae.*

*Barclays Capital U.S. Corporate 5 Year Index is an unmanaged index of public publicly issued, SEC-registered U.S. corporate debt with a remaining maturity of 4 to 6 years.*

*Barclays Capital Municipal 5 Year Index is an unmanaged index of fixed rate, investment grade, tax exempt bonds with a remaining maturity of 4 to 6 years.*

*Barclays Capital Municipal 5 Year General Obligation Index is an unmanaged index of fixed rate, investment grade, tax exempt, general obligation bonds with a remaining maturity of 4 to 6 years.*

*Barclays Capital Municipal 5 Year Revenue Bond Index is an unmanaged index of fixed rate, investment grade, tax exempt, revenue bonds with a remaining maturity of 4 to 6 years.*