

December 2009

Portfolio Commentary - December 2009

By Jill King, Vice President, Senior Portfolio Manager

While far from complete recovery, the U.S. economy has shown remarkable signs of healing - signs have been seen in manufacturing, housing, the financial sector and even the labor market. Although the economic environment has improved substantially, the short end of the fixed income curve continues to be constrained by low interest rates and too many buyers for the supply available.

The Federal Reserve, in the minutes of the December Fed meeting, reiterated its commitment to stimulating the economy and maintaining low interest rates for the foreseeable future. Most pundits are focused on how the Fed will remove the quantitative easing (or "QE") that was put in place at the end of 2008 without causing the economy to double dip into recession. The timing of the Fed's eventual return to a more normalized interest rate policy is hotly debated. But what does appear clear, however is the low likelihood that the Fed raises interest rates before the 3rd Quarter of 2010.

The continuation of a low rate policy directly impacts levels on all short investment instruments. Also, the Treasury has announced a reduction in the amount of T-Bills that will be auctioned, again creating an imbalance between supply and demand. In January, the Government Sponsored Enterprises (or "GSEs") funding needs should increase and we expect to see an up tick in the supply of both Discount Notes and longer term bonds. On December 24th, the U.S. Treasury department announced changes to their financial assistance to FNMA and FHMC. We are working on a comprehensive piece detailing the impact of the policy change for the GSEs that will be sent to clients. But in brief, the Treasury has lifted the \$200 billion maximum that FNMA (Fannie Mae) and FHLMC (Freddie Mac) can borrow from the U.S. Treasury and have given them a 3-year unlimited line of credit with the Treasury. This change in policy removes any doubt of the Treasury's continued support of the FNMA and FHLMC.

We continue to do endeavor to find "nuggets" of value in the market and to provide yield enhancement consistent with liquidity management and a conservative investment approach.

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