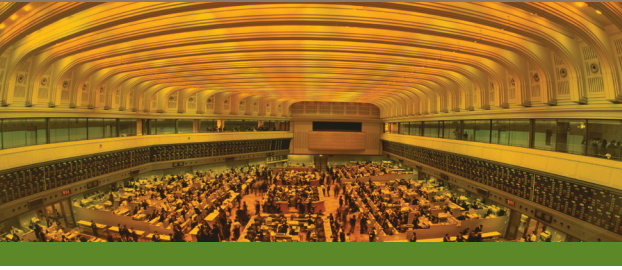


Bond Market Perspectives



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The Center of Gravity

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Highlights

European debt fears continue to keep Treasury yields pinned near their center of gravity.

Although we expect the prospect for higher yields to be limited in 2012, the margin of error for high-quality bond investors is very thin.

Over time, we believe European risks will recede and investors will refocus on the positive fundamentals and higher income generation of corporate bonds.

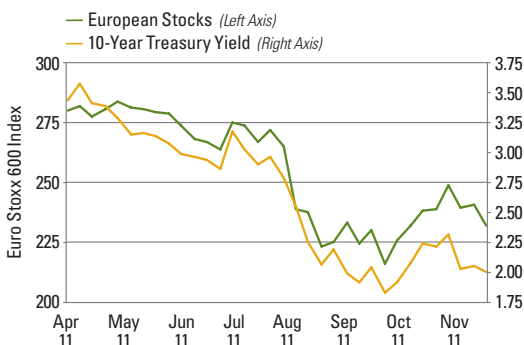
After rising to 2.4% in October 2011, the 10-year Treasury yield has reverted back near its 2.0% center of gravity. The 10-year Treasury yield has hovered around the key 2.0% benchmark for much of the past two months as investors debate the impact of European debt problems. Low Treasury yields indicate the Treasury market is still concerned that leaders are not doing enough to stem the crisis. Even with new governments forming in Greece, Italy, and now Spain, and with an apparently more serious awareness and taking steps forward, government bond prices in Italy, Spain, Belgium, and France declined further last week (November 14–18). Price declines for Spanish and Italian government debt could have been worse if not for steady buying from the European Central Bank (ECB).

European fears continue to be the driving force for the Treasury market [Chart 1]. Despite the improvement in economic data here in the United States, the 10-year Treasury yield continues to be driven by developments out of Europe as witnessed by the close correlation to European stocks.

As long as European fears persist, the 10-year Treasury yield is not likely to veer far from its center of gravity near 2.0%. In fact, should European debt fears escalate further, Treasury prices may revisit the September highs which corresponded to a 1.7% yield on the 10-year Treasury. But the stubbornness of the 2.0% yield level over the past two-and-a-half months indicates the Treasury market has mostly priced in a negative outcome [Chart 2].

Treasury prices might continue to benefit from lower yields should European debt fears escalate further. In such a case, Treasuries can still help buffer investors' portfolios. The scenario analysis below shows potential returns for the Barclays Treasury Index under a variety of interest rate scenarios over a one-year horizon.

1 Treasuries Continue to Focus on Europe



Source: Bloomberg, LPL Financial 11/21/11

Past performance is no guarantee of future results.

Change in Treasury Yields	-0.50%	-0.25%	0.00%	0.25%	0.50%	0.75%	1.00%
Total Return	5.6	4.2	2.7	1.2	-0.3	-1.8	-3.3

Source: Barclays Treasury Index 11/21/11

Assumes one-year holding period, parallel shift of yield curve, and no reinvestment of interest payments.

The Barclays Treasury Index is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

The table above highlights two interesting points.

- First, even at already historically low yields Treasuries can still benefit investors should yields be pressured lower over lingering European debt

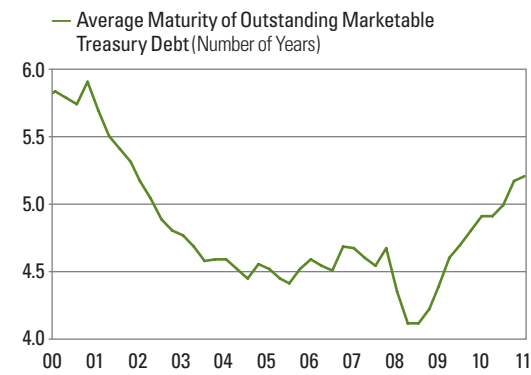


2 The 10-year Treasury Yield Has Gravitated Towards a 2.0% Level Since Late August



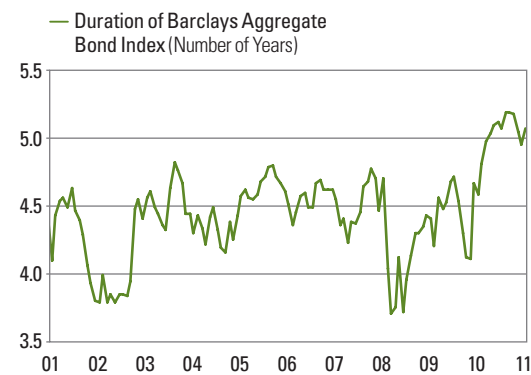
Source: Bloomberg, LPL Financial 11/21/11

3 The Treasury's Move to Extend Average Bond Maturity...



Source: Treasury, Bloomberg, LPL Financial 11/21/11

4 ...Has Pushed Bond Market Interest Rate Sensitivity Back Near a 10-year High



Source: Barclays, LPL Financial 10/31/11

The Barclays Aggregate Bond Index is an unmanaged index, which cannot be invested into directly. Past performance is no guarantee of future results.

concerns. A mere 0.25% decline in Treasury yields produces a total return of 4.2% as price appreciation would drive investor returns.

- Second, despite the fact Treasuries can still serve as a hedge, it does not take much to generate a negative total return. Should interest rates rise just one-half of one percentage point, investors would suffer a loss. This is a very thin buffer. A 1.0% rise in bond yields produces a 3.3% loss. Considering a 1.0% rise in 10-year Treasury yields would take the 10-year, for example, to 3.0% — where it was this past July—this is certainly possible.

A more diversified portfolio of high-quality bonds, broadened out to include government agency mortgage-backed securities and investment-grade corporate bonds, provides a better total return profile, but the margin of safety is still small. Total returns turn negative once the increase in bond yields exceeds 0.8% according to our calculations and Barclays Aggregate Bond Index data.

Change in Bond Yields	-0.50%	-0.25%	0.00%	0.25%	0.50%	0.75%	1.00%
Total Return	6.7	5.4	4.1	2.8	1.5	0.2	-1.1

Source: Barclays Treasury Index 11/21/11

Assumes one-year holding period, parallel shift of yield curve, and no reinvestment of interest payments.

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Two factors drive the variability of returns and a defensive buffer against rising interest rates that is relatively thin by historical comparison:

- Greater interest rate sensitivity.** Like residential homeowners and other bond issuers, the Treasury department has taken advantage of low borrowing costs and locked in attractive rates of longer-term financing. The Treasury has extended the average maturity of its debt in the process [Chart 3]. The Treasury's maturity extension was widely anticipated and certainly prudent given persistently low interest rates. However, the implication for investors is that the broad bond market now has greater interest rate sensitivity and could lead to more volatile bond performance. Interest rate sensitivity of the broad bond market, as measured by duration, remains near its highest levels of the past 10 years [Chart 4]. This higher level of interest rate sensitivity has helped propel high-quality bond prices in 2011, but duration works both ways and could work against high-quality bonds going forward.
- Lower yields.** With yields at or near historic lows, interest income plays a reduced role in bond market total returns. Low bond yields provide less of a buffer against rising interest rates and hence the reason that even a modest rise in interest rates could translate into losses for high-quality bond investors.

The caveat is that interest rates must rise for this risk to be realized. Over the remainder of 2011, Europe appears unlikely to take decisive steps to quickly resolve its debt issues and Treasury yields will likely stay near current levels—their center of gravity. As we look out into 2012, we expect interest rates to be largely range bound but ultimately finish 2012 higher. Therefore,



we expect a low return environment for high-quality bonds next year and the margin of error for a zero return or even a loss is thin. Once Europe takes the necessary steps to address debt issues (as we believe they eventually will), investors will refocus on an improving U.S. economy and a healthy corporate America as evidenced in the recent earnings season. Corporate bonds, high-yield in particular, should benefit from a renewed focus on these fundamental factors as well as the higher level of income which not only provides a buffer against higher interest rates but also serves as a key driver of return.

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise, are subject to availability, and change in price.

Government bonds and Treasury Bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of a fund shares is not guaranteed and will fluctuate.

Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity and redemption features.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.

Yield Curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality, but differing maturity dates. The most frequently reported yield curve compares the three-month, two-year, five-year and 30-year U.S. Treasury debt. This yield curve is used as a benchmark for other debt in the market, such as mortgage rates or bank lending rates. The curve is also used to predict changes in economic output and growth.

International and emerging markets investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

Stock investing may involve risk including loss of principal.

Mortgage-Backed Securities are subject to credit, default risk, prepayment risk that acts much like call risk when you get your principal back sooner than the stated maturity, extension risk, the opposite of prepayment risk, and interest rate risk.

The Barclays Treasury index is an unmanaged index of public debt obligations of the U.S. Treasury with a remaining maturity of one year or more. The index does not include T-bills (due to the maturity constraint), zero coupon bonds (Strips), or Treasury Inflation Protected Securities (TIPS).

Barclays Aggregate Bond Index is comprised of the Barclays Government/Corporate Bond Index, Mortgage-Backed Securities Index, and Asset-Backed Securities Index, including securities that are of investment-grade quality or better, have at least one year to maturity, and have an outstanding par value of at least \$100 million.

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