

Short Term Investing Strategies

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Presented by:

Michael P. Rodgers - Managing Director, Institutional Fixed Income

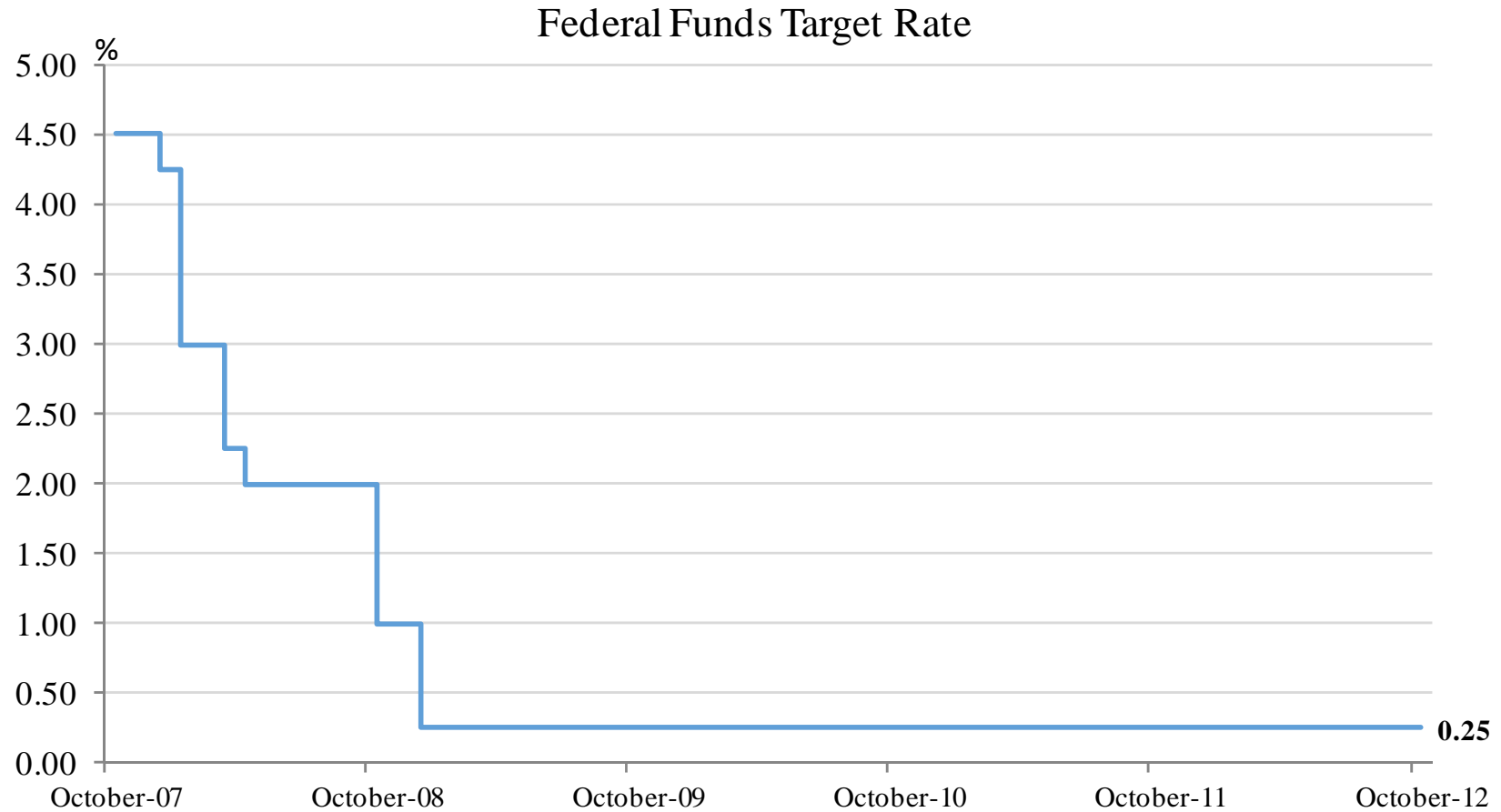


WELLS CAPITAL MANAGEMENT



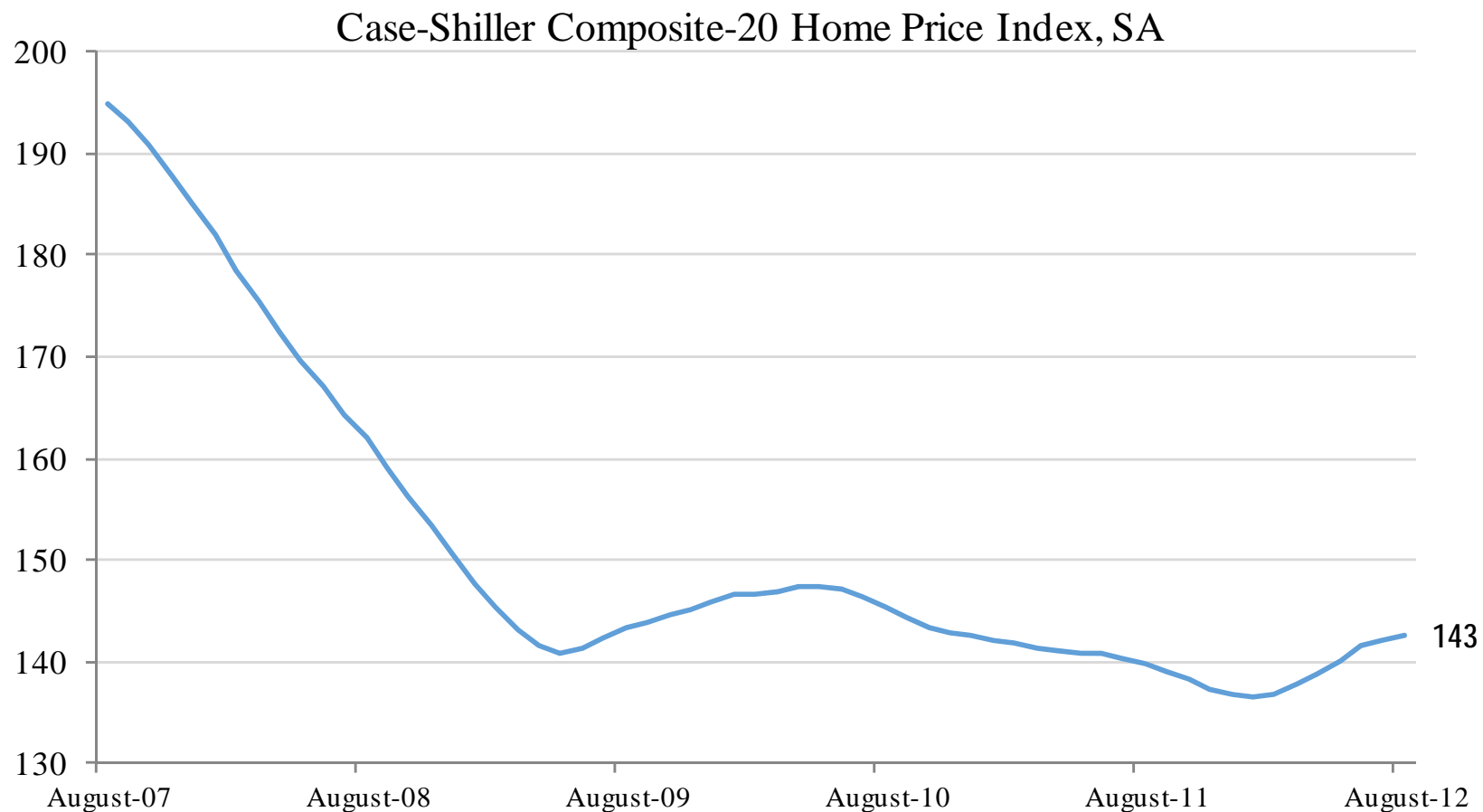
Where Have We Been?

- ▶ The Federal Reserve has signaled that they will not raise rates until mid 2015. Short to intermediate rates centered around the 2yr tend to move ahead of the Fed.



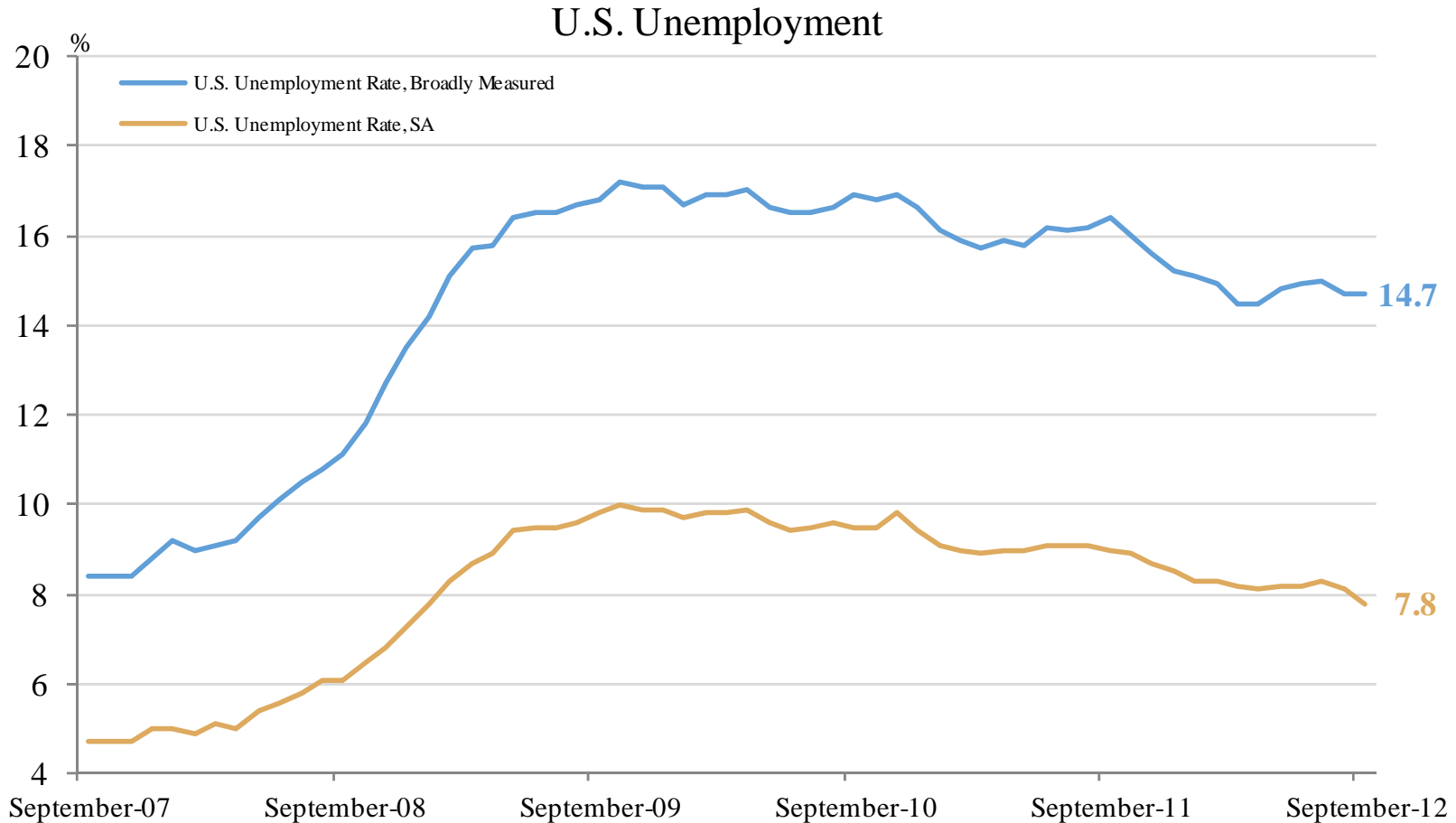
U.S. Home Prices Seem To Have Found A Bottom

- Home prices looked as though they had found a bottom, however recent increases may overstate the rise of the next 12-18 months.



U.S. Unemployment Measurements

- ▶ The unemployment rate been above 8% for more than three years. Also of trouble is the underemployment rate which includes those working part-time out of necessity and discouraged workers who have dropped out of the work force. The spread between the two measures is currently much higher than the historical average.



Current Issues Potentially Impacting Operating Reserve Fund Flows

➤ **Money Market Mutual Fund Reform**

- Mandated decrease in weighted average maturity of securities from 90 days to 60 days.
- Under consideration
 - Floating NAV
 - Holdback of principal or interest
 - Capital buffer
- SEC withdraws reform proposals vote
- Now with the Financial Stability Oversight Council (FSOC) – chaired by Tim Geithner

➤ **Transaction Account Guarantees (TAG)**

- Unlimited FDIC insurance for non-interest bearing deposits first provided as a backstop in 2008
- The Dodd-Frank Act said all banks must participate
- Congress extended in 2010
- Set to expire on 12/31/2012
- \$2.3 trillion in noninterest-bearing deposits at U.S. banks since the start of this program (source: FDIC)

Most Recent Policy Actions

➤ **Extension of Operation Twist**

- Continuation of operation twist until December, selling short maturity Treasurys in favor of longer maturity Treasurys.
- Amended language on commitment to low short term rates from late 2014 to mid 2015.

➤ **Additional MBS Purchases**

- The Fed will expand its holdings by purchasing \$40 billion of agency mortgage-backed debt per month for an open-ended amount of time.
- The FOMC stated that these purchases were warranted and would continue until the outlook for the labor market improved substantially.

➤ **ECB Outright Monetary Transactions (OMT)**

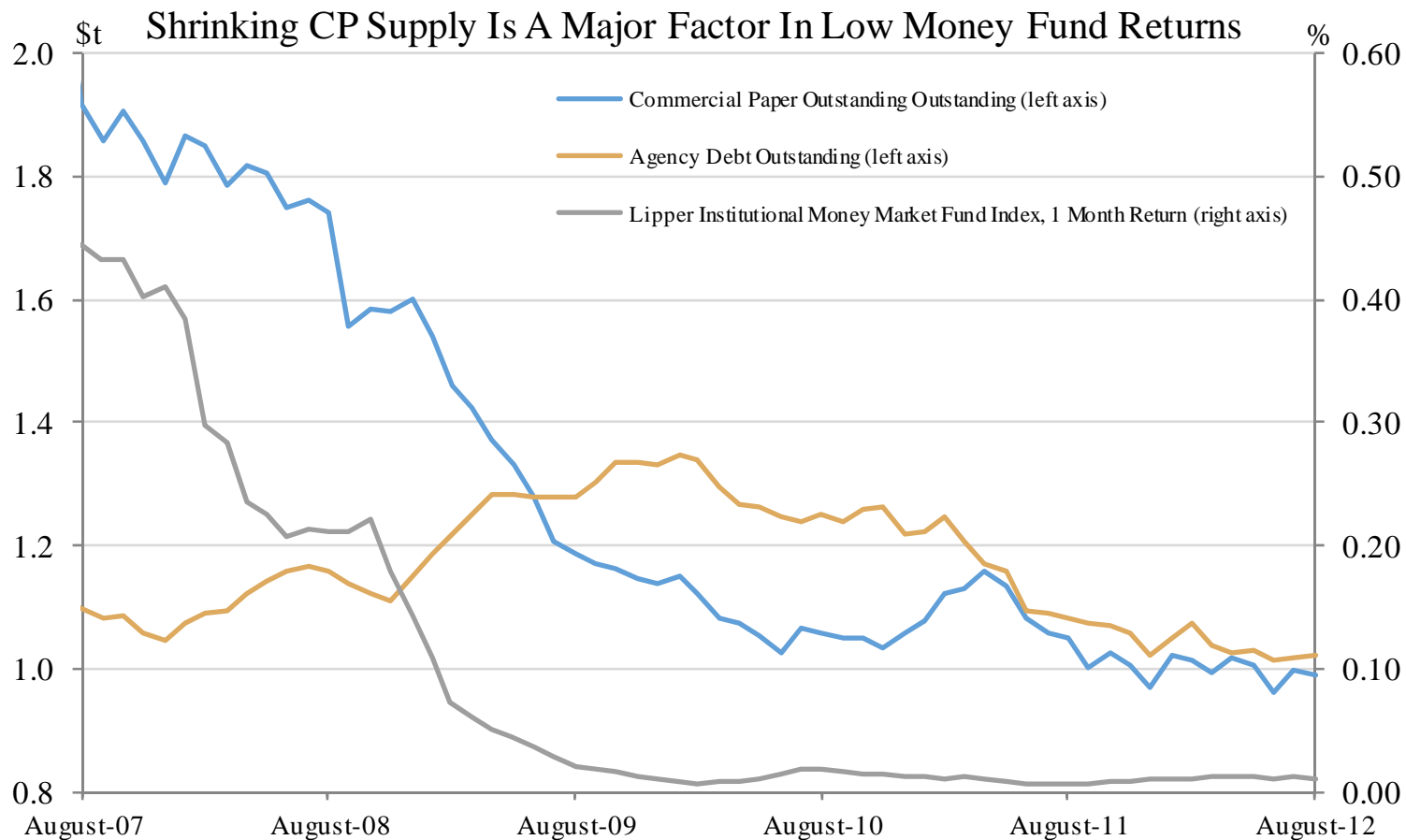
- Involves the purchase of short-term securities in the secondary market to supplement EFSF/ESM purchases of longer maturities in the primary market.
- To be eligible for this program, countries have to meet fiscal conditions agreed upon by the ECB, Euro governments and the IMF.

➤ **Quest for Yield**

- The need for yield will likely push investors further out both the credit and yield curve as companies have hurdle rates that need to be met.

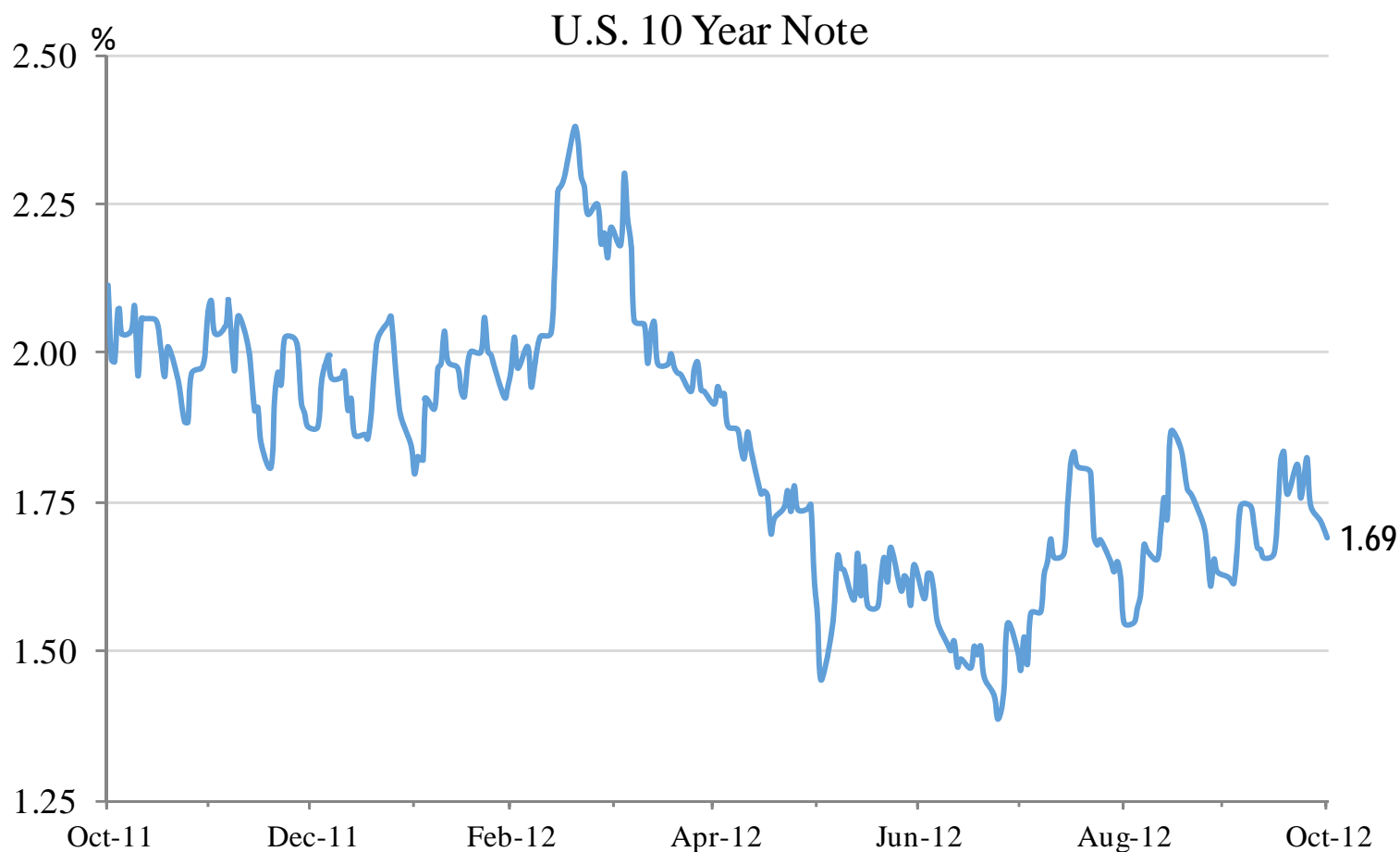
Headwinds for Money Market Funds

- ▶ CP outstanding has declined 54% from a peak of \$2.16t in July 2007.
- ▶ Federal Agencies are expected to decrease issuance at an increasing rate as they have been mandated to shrink the size of their balance sheets at a rate of 10-15% per annum.



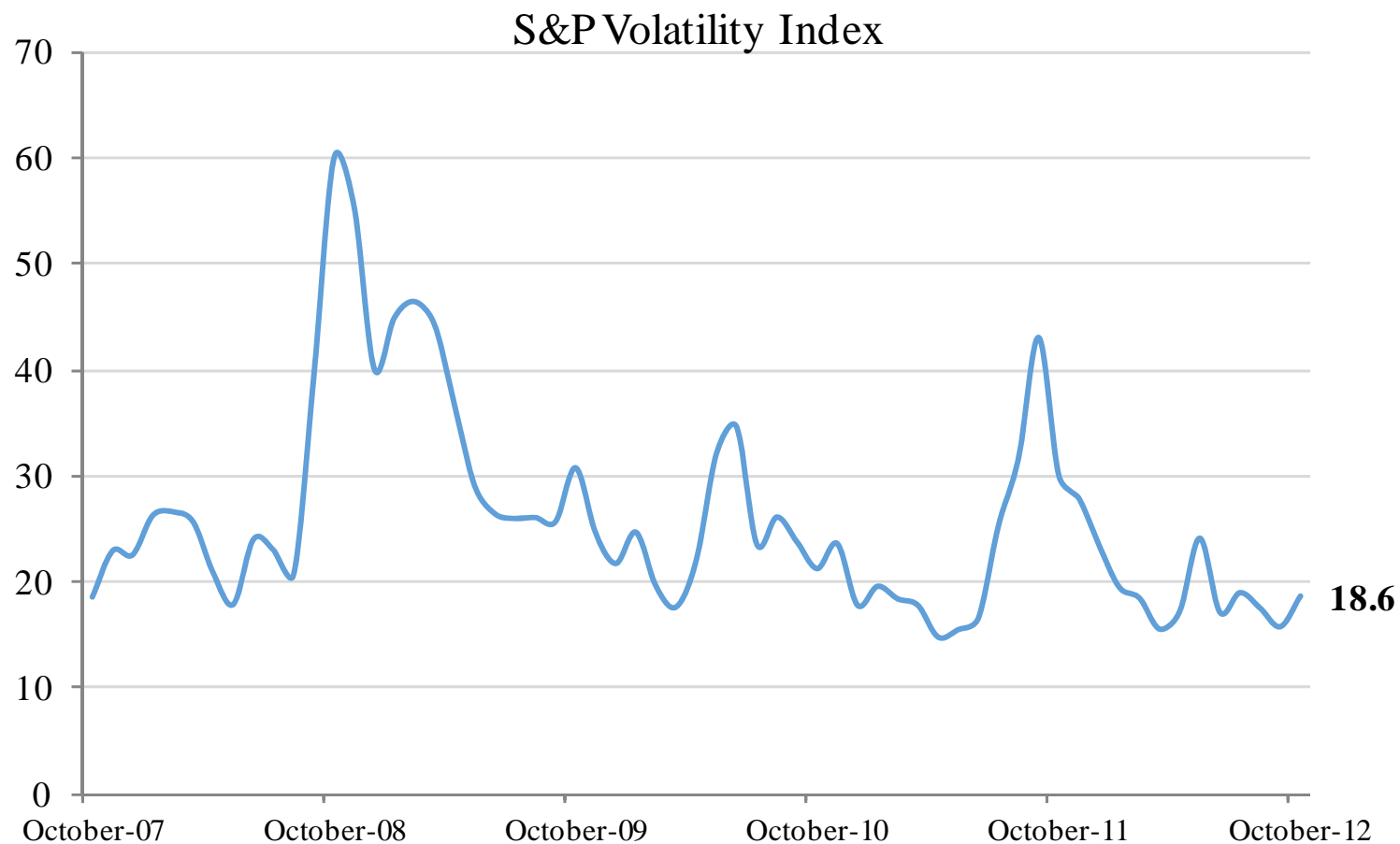
S&P Downgrade of U.S. Government Long-Term Debt

- ▶ The U.S. 10 Year Note was yielding 2.56% when the government was downgraded on August 5, 2011. Recently, the 10 Year has been fairly range-bound between 1.50% and 2.00%.



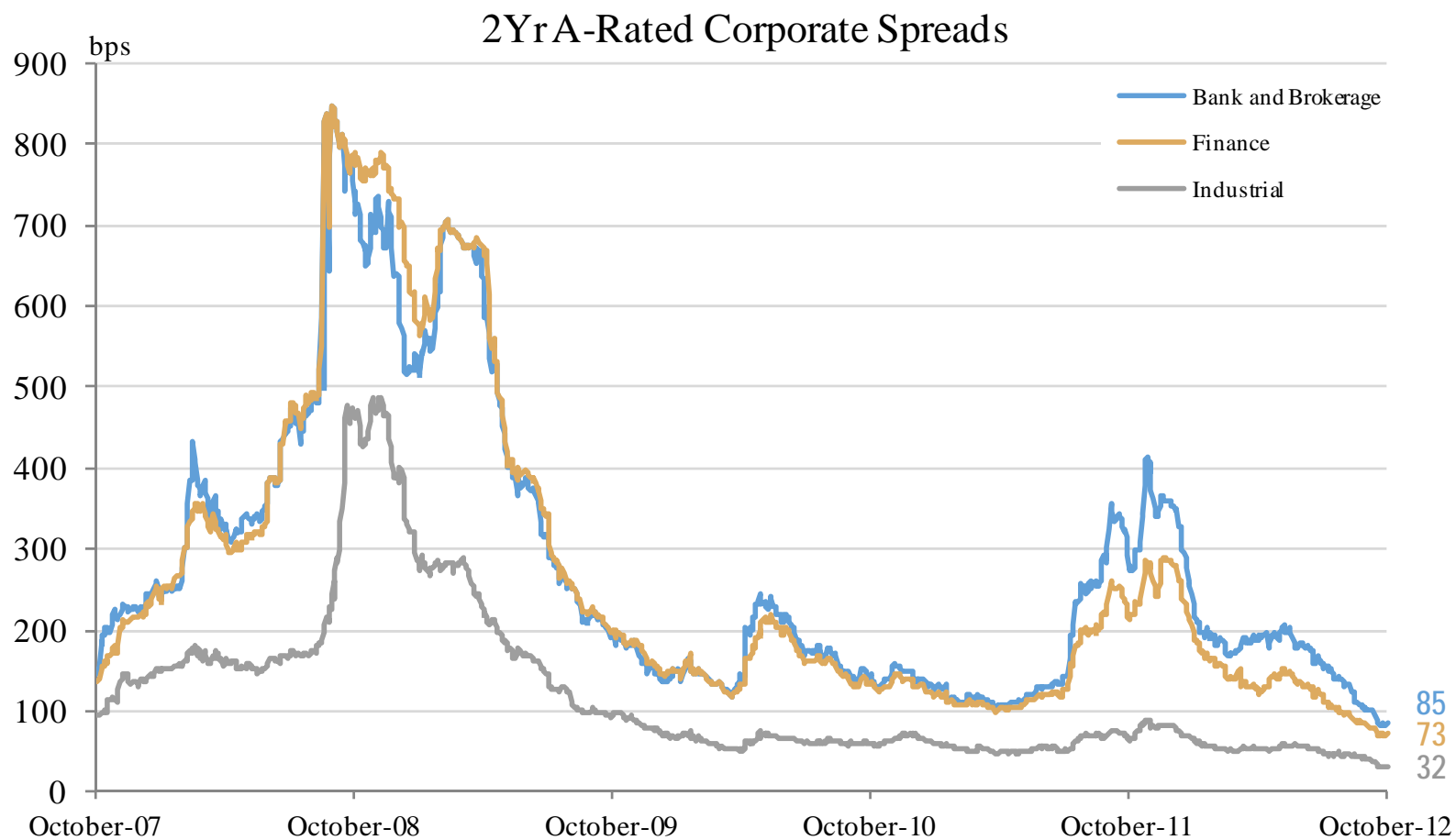
Risk On / Risk Off Trade Has Created Increased Volatility

- Volatility in the equity markets is far off the highs seen in 2008-2009. The S&P has had two impressive runs up over 1,400 in 2012.



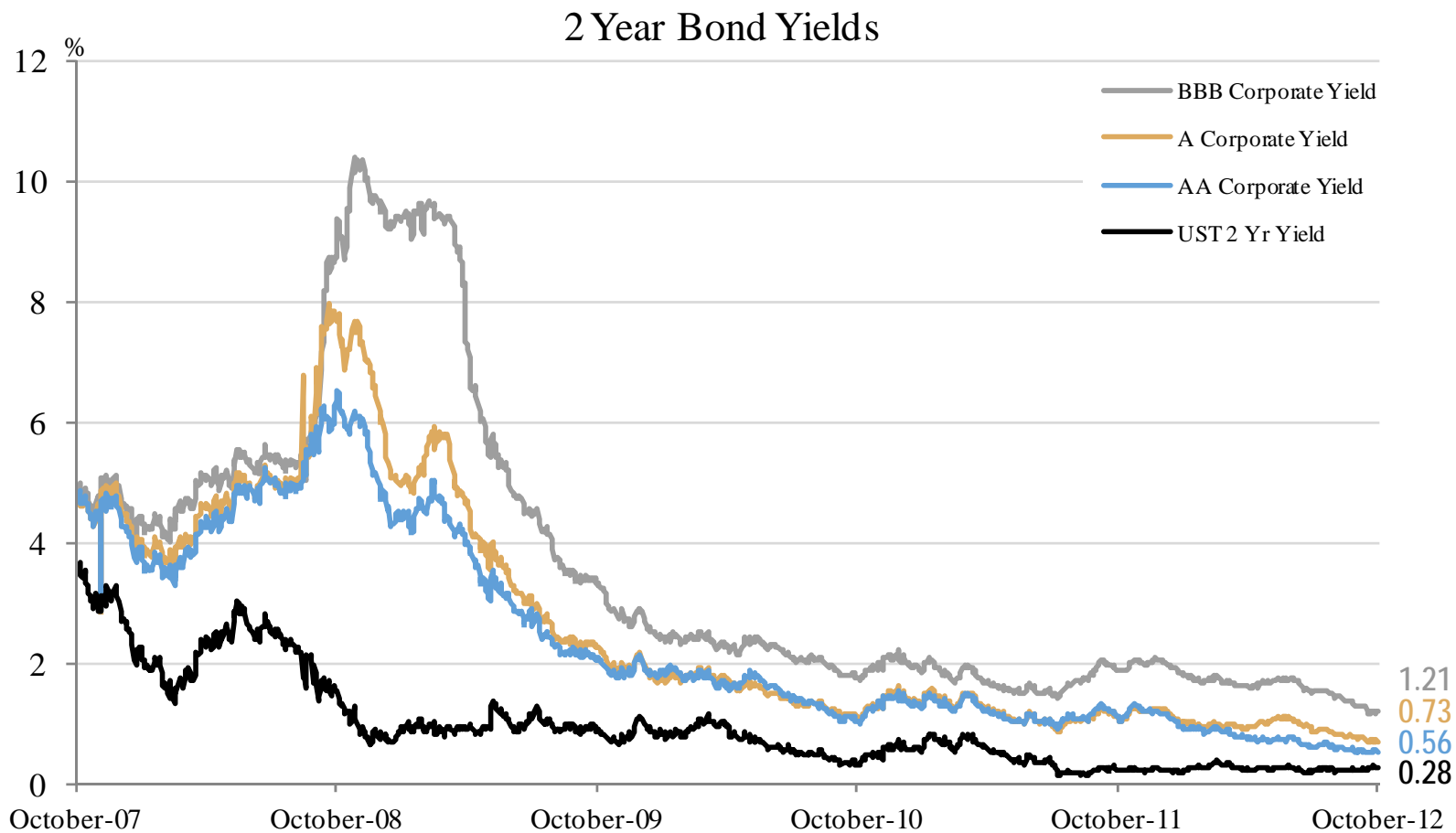
Spreads in Corporate Bond Markets

- Financial spreads remain elevated vs. industrials on a historical basis due to continued uncertainty around bank and brokerage companies.



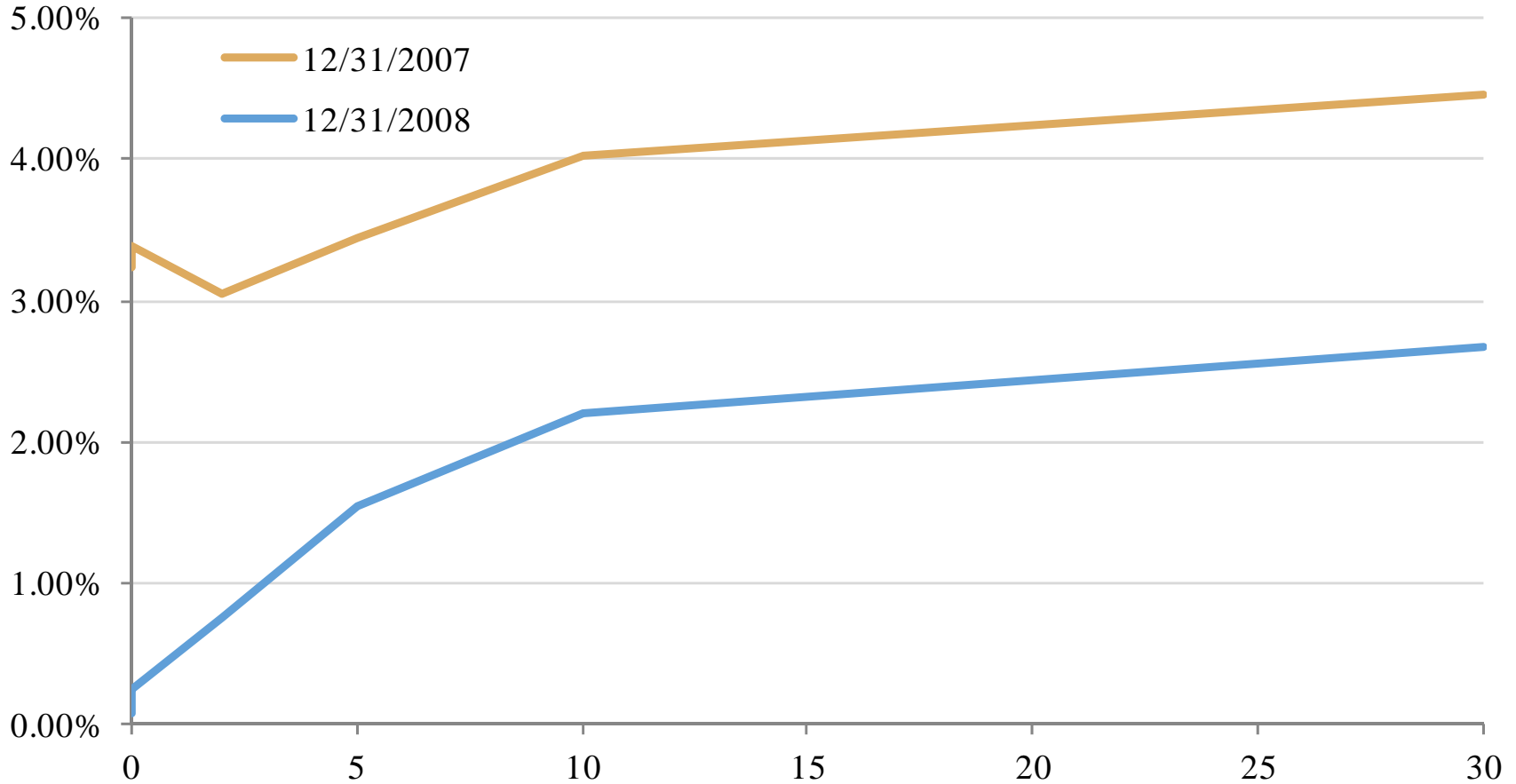
Corporate Yields

- Across the board yields are well off the highs and are below pre-crisis levels. We expect the front end of the Treasury curve to be anchored for some time.



2008 Treasury Index Return

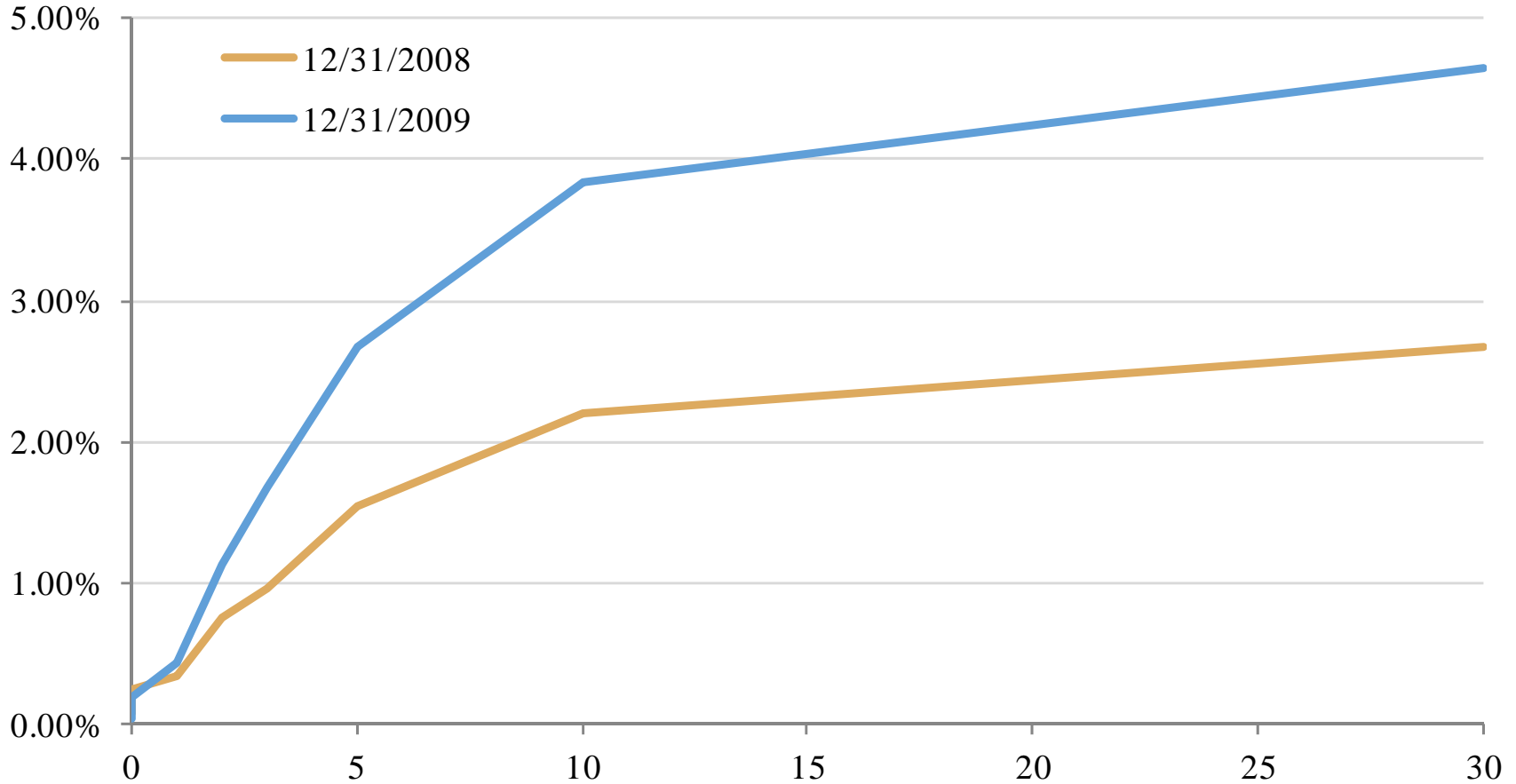
	1-3 Yr	3-5 Yr	5-7 Yr	7-10 Yr	10+ Yr
Total Return	6.61%	12.15%	15.11%	17.91%	24.36%
Price Return	2.68%	7.83%	9.92%	12.58%	18.08%
Income Return	3.93%	4.32%	5.18%	5.34%	6.28%



Source: Wells Capital Management, Bank of America/Merrill Lynch, Bloomberg

2009 Treasury Index Return

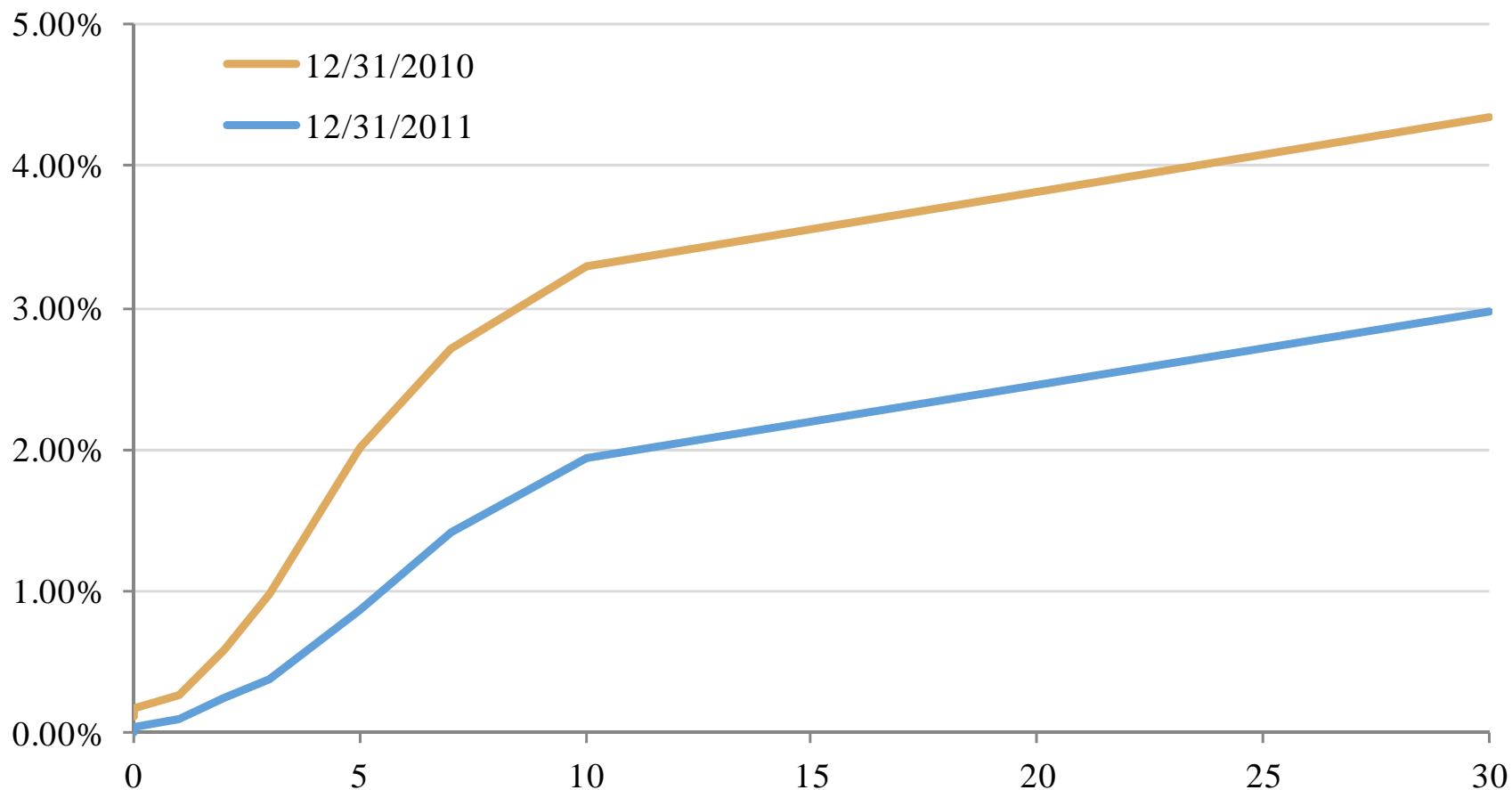
	1-3 Yr	3-5 Yr	5-7 Yr	7-10 Yr	10+ Yr
Total Return	0.79%	-0.67%	-2.90%	-5.87%	-13.04%
Price Return	-1.83%	-3.65%	-6.76%	-9.69%	-17.21%
Income Return	2.61%	2.98%	3.86%	3.83%	4.17%



Source: Wells Capital Management, Bank of America/Merrill Lynch, Bloomberg

2011 Treasury Index Return

	1-3 Yr	3-5 Yr	5-7 Yr	7-10 Yr	10+ Yr
Total Return	1.55%	6.23%	10.96%	15.15%	29.06%
Price Return	-0.15%	3.58%	7.63%	11.25%	23.65%
Income Return	1.70%	2.65%	3.33%	3.90%	5.42%

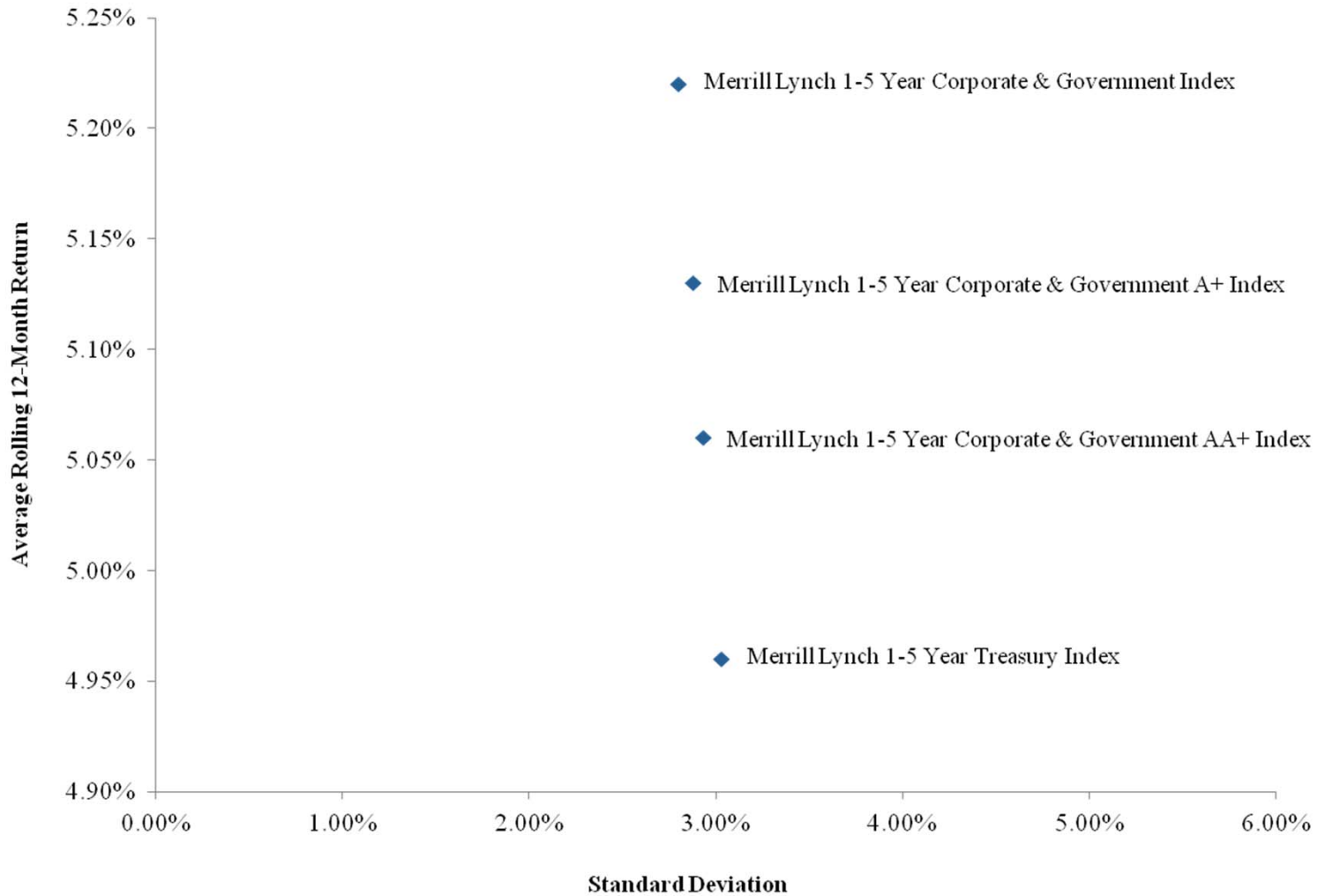


Where We See Value

- ▶ **Overweight**
 - Corporate bonds
 - Municipal bonds

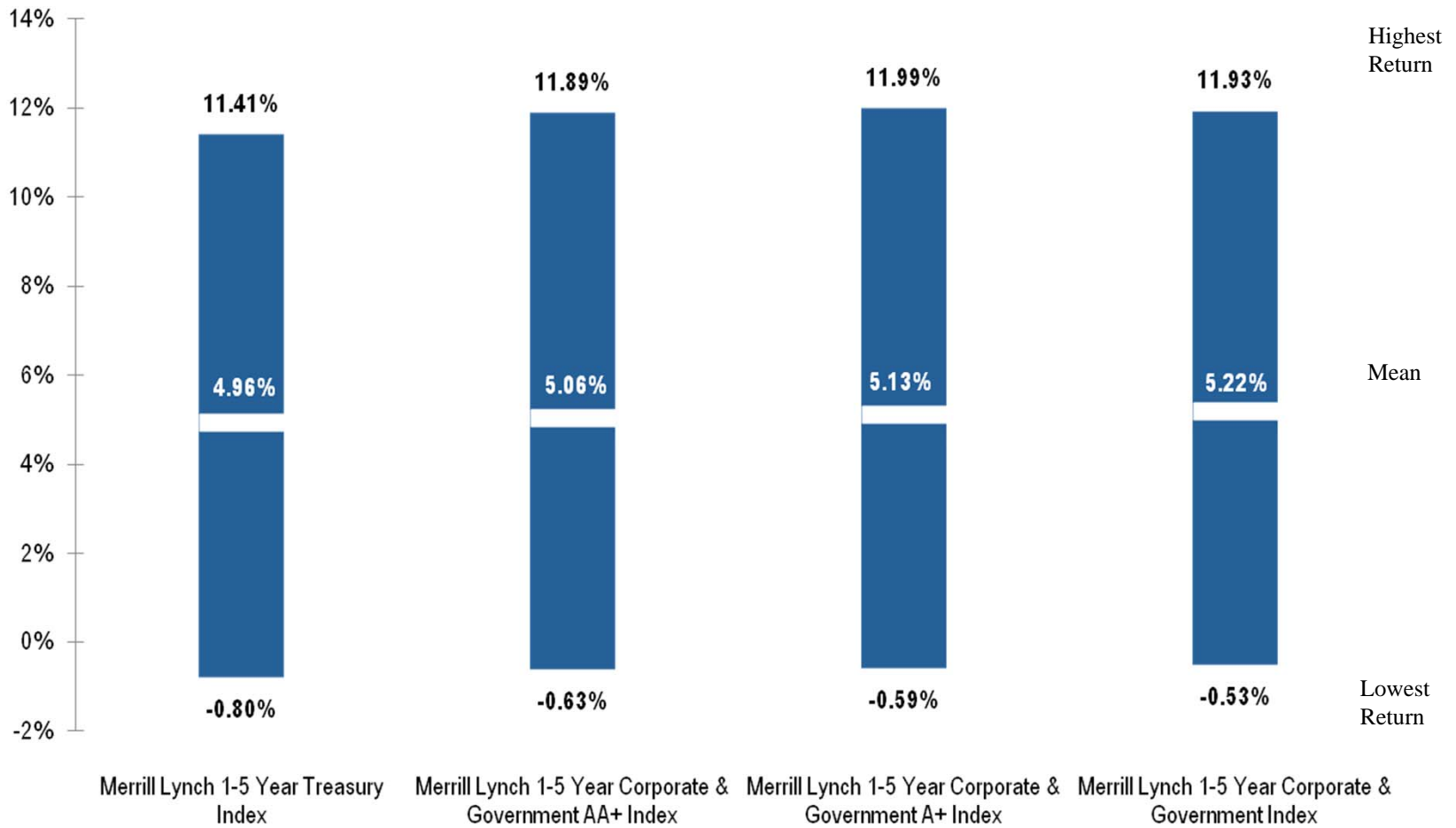
Including Credit Risk Has Historically Enhanced Returns and Reduced Volatility

1997-2011 Rolling 12-Month Returns At Each Quarter-End



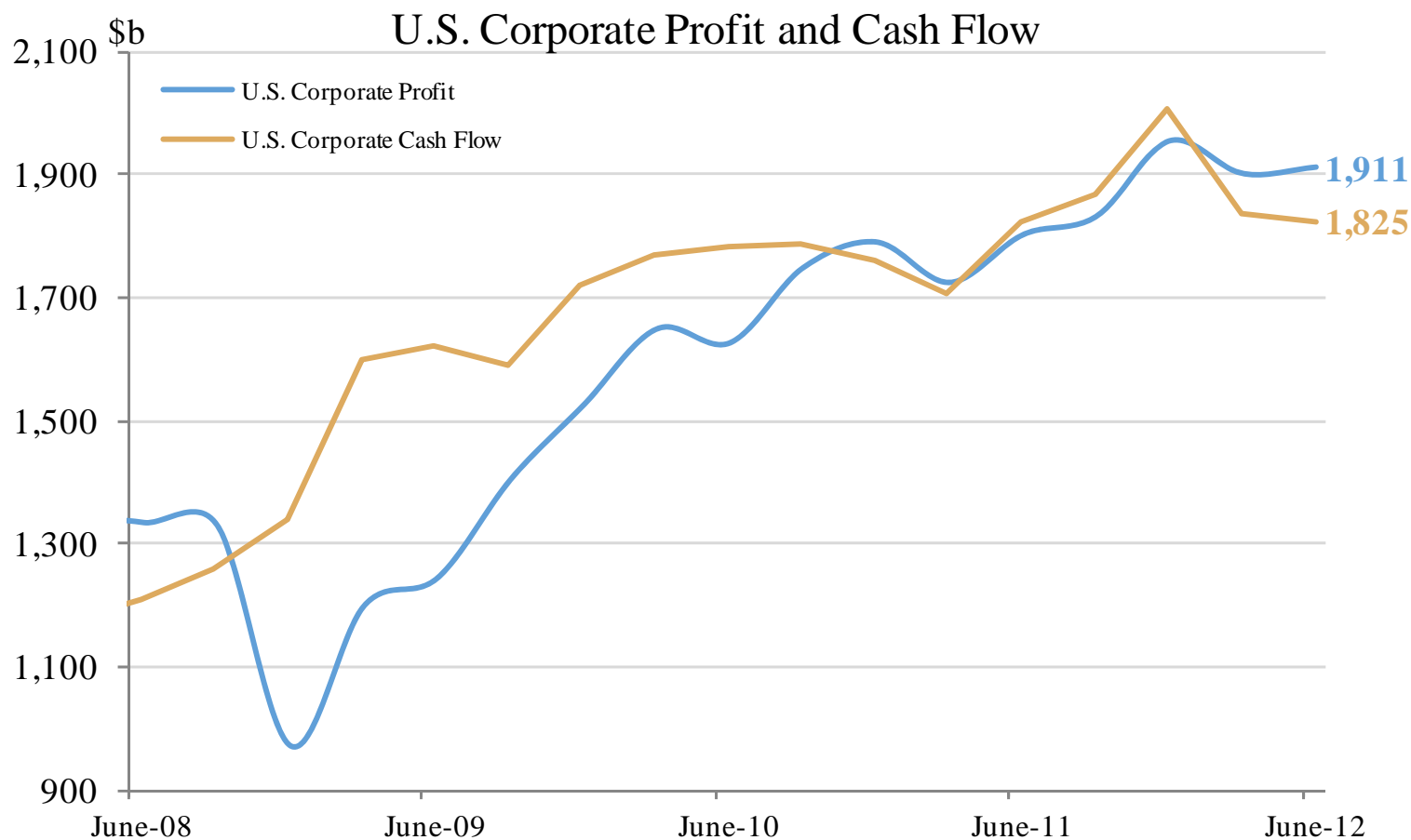
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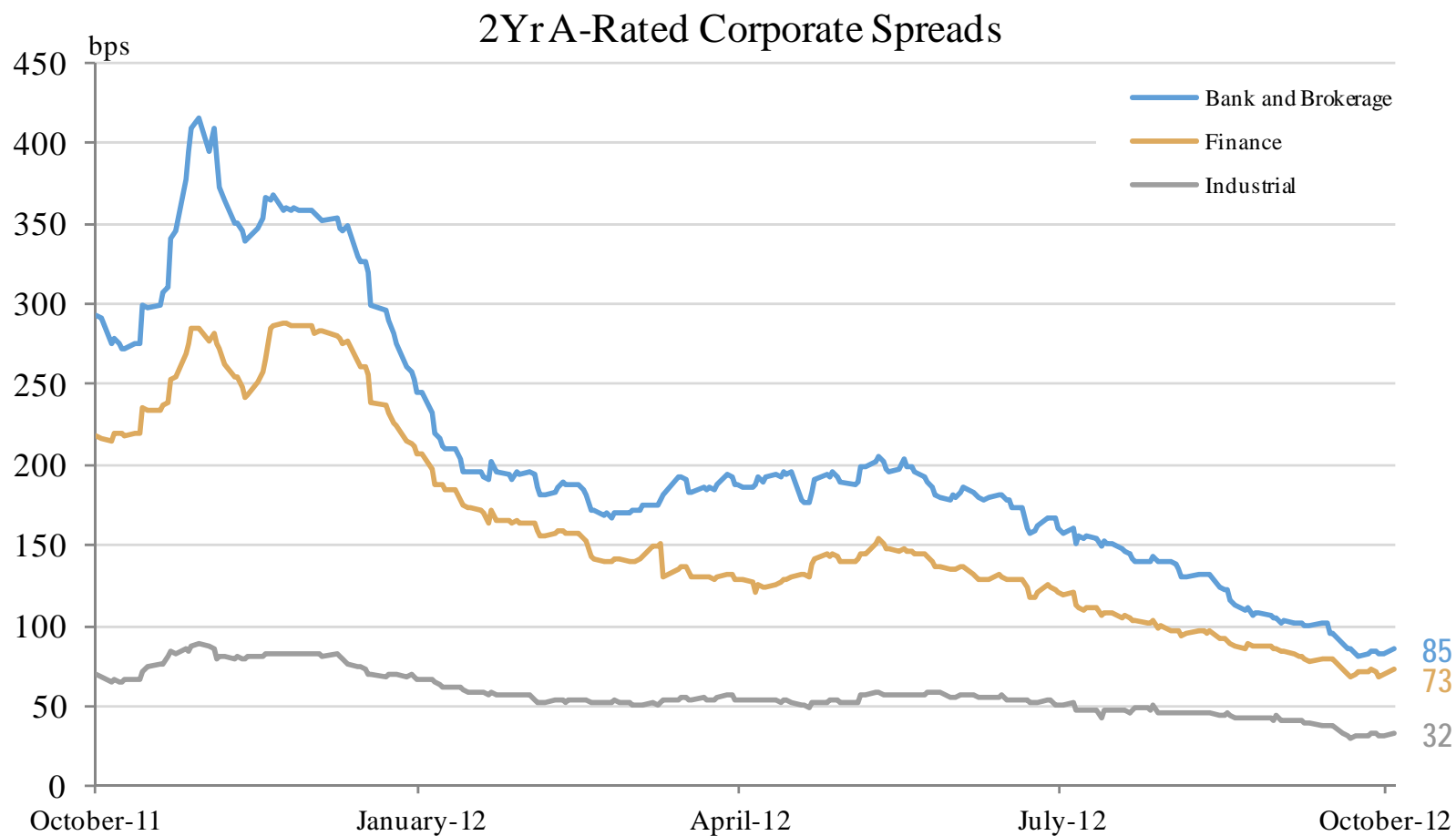
Credit Fundamentals Remain Strong

- U.S. corporate profits and cash flow are near all-time highs due to aggressive cutting during the recession. Corporate balance sheets remain very healthy.



Current Corporate Spreads

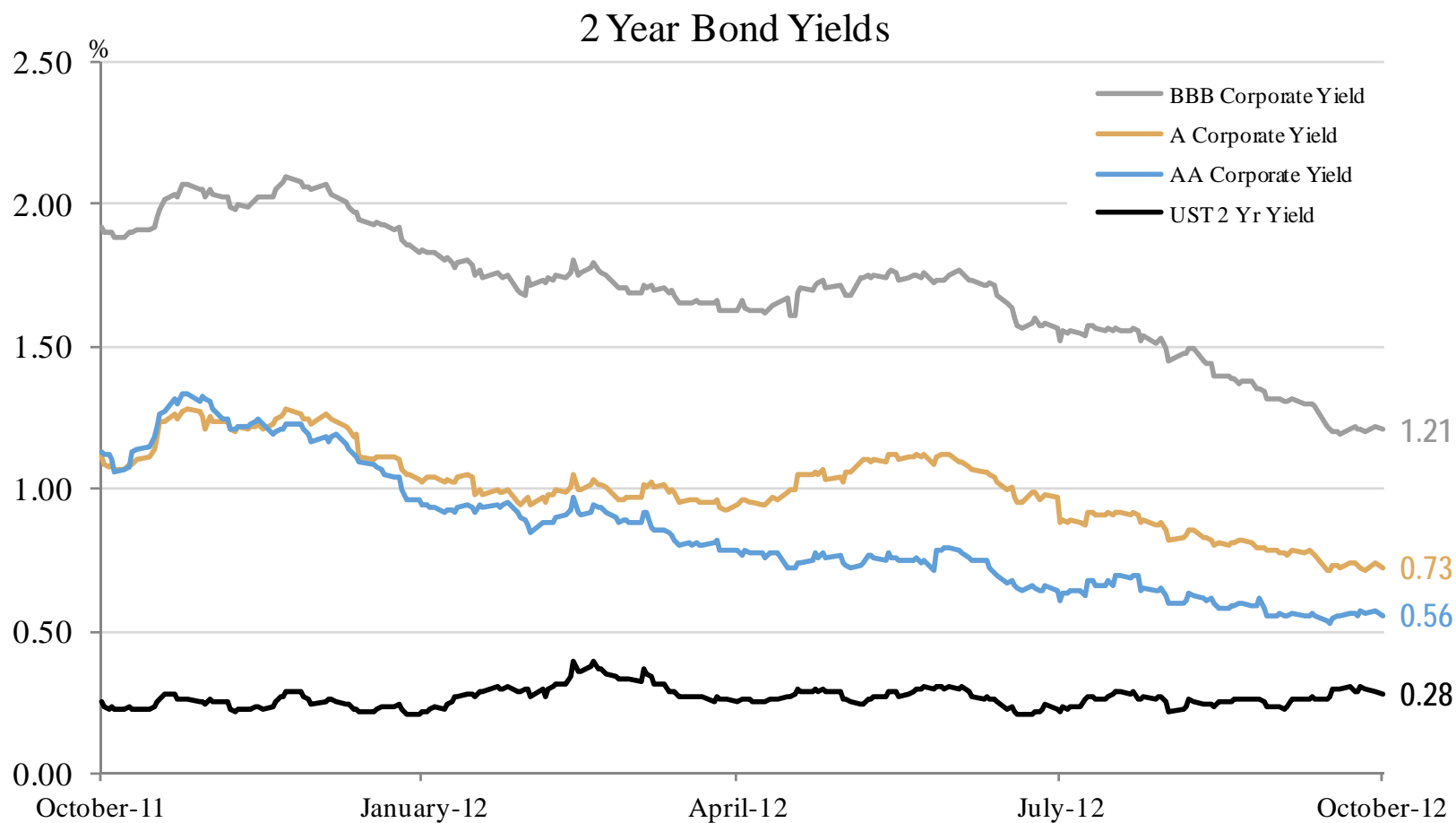
- ▶ Select bank and brokerage and finance names present value at current levels. We see room for further spread compression even after the large move since year end.



Source: Wells Capital Management, Bloomberg

Current Corporate Yields

- ▶ The divergence between AA and BBB corporate bond yields makes BBBs look attractive. Further, BBB bonds offer increased diversification into the industrial sector.

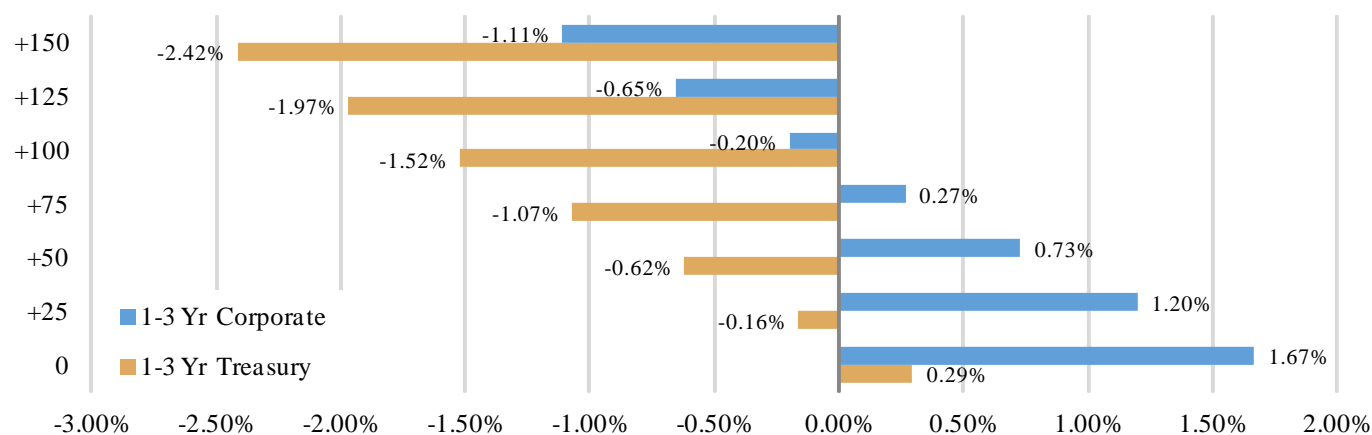


Coupon Payments In A Rising Rate Environment

- In a rising rate environment, coupon payments can provide insulation to negative price action.

Immediate parallel shift, 12m horizon

1-3 Yr Corporate				1-3 Yr Treasury				Outperformance	
Scenario	Total Return	Price	Income	Scenario	Total Return	Price	Income	Scenario	Total Return
0	1.67%	0.00%	1.67%	0	0.29%	0.00%	0.29%	0	1.37%
+25	1.20%	-0.48%	1.67%	+25	-0.16%	-0.46%	0.30%	+25	1.36%
+50	0.73%	-0.95%	1.68%	+50	-0.62%	-0.92%	0.30%	+50	1.35%
+75	0.27%	-1.42%	1.68%	+75	-1.07%	-1.37%	0.30%	+75	1.34%
+100	-0.20%	-1.89%	1.69%	+100	-1.52%	-1.83%	0.30%	+100	1.33%
+125	-0.65%	-2.35%	1.69%	+125	-1.97%	-2.27%	0.30%	+125	1.32%
+150	-1.11%	-2.81%	1.70%	+150	-2.42%	-2.72%	0.31%	+150	1.30%



Perspective on Municipal Defaults - \$3.7 Trillion Municipal Market

Defaults have occurred, but at a very small rate relative to the overall municipal market. Below are total bankruptcies, missed payments and debt service reserve fund draws. Actual missed payments are in parenthesis.

- 2008 = \$8.15 B (\$1.6 B) – 0.22%
- 2009 = \$8.78 B (\$3.4 B) – 0.24%
- 2010 = \$5.13 B (\$4.3 B) – 0.14%
- 2011 = \$25.29 B (\$2.4 B) – 0.68%
- 2012 = \$2.48 B (\$1.69 B) as of 9/21/12

Source: Federal Reserve, Distressed Debt Newsletter, Bank of America Merrill Lynch

Comparative Default Rates for Municipal and Corporate Debt

	Municipal (%)	Corporate (%)
AAA	0.00	1.32
AA	0.05	1.54
A	0.09	3.25
BBB	0.41	8.07
BB	2.68	21.14
B	10.54	35.06
CCC/C ²	41.28	60.00
Investment-Grade	0.15	4.39
Speculative-Grade	7.48	30.58

(15-Year Cumulative Default Rates)¹

- Historically, a BBB municipal bond has a cumulative default rate less than a AAA corporate bond.
- Credit fundamentals in the municipal market supports attractive risk-adjusted returns.
- Credit decision is a large driver of the crossover investment decision.

¹For municipal defaults, S&P's study period was Jan. 1, 1986, to Jan. 1, 2012. For corporate defaults, S&P's study period was Jan. 1, 1981 to Jan. 1, 2012.

²Calculations include all ratings in the C category, from Caa/CCC to C/C.

Source: S&P



The Case For Municipals

- Municipal bonds offer a compelling investment option as the market is structurally and fundamentally unique from other asset classes.
 - Historically, the municipal market is less correlated with traditional fixed income sectors.
 - The municipal market is owned in large part by retail investors who typically take a buy and hold approach to their municipal bond holdings.
 - The near-elimination of municipal bond insurance has created significant opportunities for institutional investors with deep credit research capabilities.

5 Year Monthly Return Correlations:

	Municipal Bond - MTD Total Return	U.S. Treasury - MTD Total Return	U.S. Agencies - MTD Total Return	U.S. Corporate - MTD Total Return	AAA ABS - MTD Total Return
Municipal Bond - MTD Total Return	1.00	0.14	0.18	0.48	0.43
U.S. Treasury - MTD Total Return		1.00	0.92	0.40	0.29
U.S. Agencies - MTD Total Return			1.00	0.56	0.41
U.S. Corporate - MTD Total Return				1.00	0.56
AAA ABS - MTD Total Return					1.00



Source: Wells Capital Management, Barclays

Ways To Achieve Your Investment Portfolio Objectives

▶ **CalTRUST** - Cal Code compliant

- Money market fund (31 days, 0.15%)
- Short term fund: (0.58 years, 0.34%)
- Medium term fund: (1.80 years, 0.79%)

▶ **Separately Managed Account**

- Outsource to professional money management firm to manage portfolio and navigate the markets. Portfolio size may be a barrier to entry for some entities preferring this option.

▶ **In-House Portfolio Management**

- Must have the capacity and willingness to invest in your own investment tools. (i.e. credit research, economic research, bond modeling software). It is necessary to have dedicated, seasoned market professionals to effectively manage portfolios on a daily basis.

Questions and Contact Information

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