Payden&Rygel Weekly Market Update

For the Week Ending February 11, 2011

MARKET LEVELS

	Friday*	Last week	Dec. 31, 2010	One year ago
Dow Jones Industrial Avg	12,233	12,092	11,578	10,144
S&P 500	1,324	1,311	1,258	1,078
NASDAQ	2,798	2,769	2,653	2,177
Russell 2000	817	800	784	605
DJ STOXX Europe 600 (€)	288	286	276	242
Nikkei Index (¥)	10,606	10,544	10,229	9,964
MSCI EM Index	373	387	393	326
Fed Funds Target	0%-0.25%	0%-0.25%	0%-0.25%	0%-0.25%
2-Year Treasury Yield	0.82%	0.75%	0.60%	0.87%
10-Year Treasury Yield	3.65%	3.64%	3.30%	3.72%
U.S. $ / Euro	1.35	1.36	1.34	1.37
U.S. $ / British Pound	1.60	1.61	1.56	1.57
Yen / U.S. $	83.59	82.43	81.19	89.79
Gold ($/oz)	$1,357.88	$1,348.85	$1,420.78	$1,095.40
Oil	$85.86	$89.03	$91.38	$75.28

Levels reported as of 9:10 a.m. Pacific Standard Time

MARKET RETURNS

Year-to-date (1/1/10-2/11/11)*

Dow Jones Indus Avg.	5.66%
S&P 500	5.28%
NASDAQ	5.46%
Russell 2000	4.23%
MSCI World Index	4.51%
DJ STOXX Europe 600	4.42%
MSCI EM Index	-4.94%

Year-to-date (1/1/10-2/10/11)

90 Day T-Bill	0.02%
2-Year Treasury	-0.36%
10-Year Treasury	-2.88%
ML High Yield Index	2.79%
JPM EMBI Global Diversified	-0.96%
JPM Global Hedged	-1.39%

Returns reported as of 9:10 a.m. Pacific Standard Time

RECAP OF THE WEEK'S ECONOMIC RELEASES

February 10 — **Initial Claims** – First-time claims for unemployment benefits dropped last week to 383,000, their lowest level in over two years. The four-week moving average also fell to 415,500.

Wholesale Inventories and Sales – Wholesalers saw their inventories increase by 1.0% in December after staying flat in November. Sales at wholesalers grew more slowly at 0.4%, pushing up the inventory/sales ratio for the month.

February 11 — **Trade: Balance of Payments** – The U.S. trade deficit widened slightly in December to -$40.6 billion as petroleum prices pushed imports up faster than exports.

OVERVIEW

While last week's jobs report showed a welcome drop in the unemployment rate to 9.0% from 9.4%, we believe the pace of job creation is insufficient to shift Fed policy for now. The FOMC's "longer run" expectations for the unemployment rate are still between 5% and 6%, and reaching 6% might take a considerable amount of time. In the two instances in the post-war era where the unemployment rate fell from 9% to 6%, the process took a while: May 1975-August 1978 (39 months) and December 1983-October 1987 (49 months). This pattern of protracted employment recovery is important because, in the words of Fed Chairman Ben Bernanke, "Until we see a sustained period of job creation, we cannot consider the recovery to be truly established." In our view, this means several consecutive months of job gains in the 200,000 range or beyond. Job gains, not just the unemployment rate, will be a key focus.

US MARKETS:

TREASURIES

- Treasury yields oscillated meaningfully each day this week, but ended the week largely where they started. Crosswinds stemming from improved domestic economic data, strong demand for the 10-year Treasury auction and geopolitical headlines gave Treasury investors plenty to consider when positioning portfolios. Initial jobless claims fell to their lowest level in over two years, while over 71% of the Treasury auction was awarded to indirect bidders which represented the largest-ever participation rate among indirects. Indirect bidders are considered foreign central banks, as well as any other participants that submit bids via primary broker-dealers.

LARGE-CAP EQUITIES

- The stock market rallied for the second consecutive week as increased merger and acquisition activity offset geopolitical and inflationary concerns in developing countries. The S&P 500, Dow Jones Industrial Average and NASDAQ Composite indices all finished the week approximately 1% higher. Small-cap stocks outperformed large-cap stocks. In terms of style, large-cap growth stocks performed in line with large-cap value stocks. The best performing sector was consumer discretionary, while the worst performing sector was energy. Out of 348 companies in the S&P 500 index, 74% have beaten analysts' earnings estimates. One notable beat this week, Disney, reported 1st quarter earnings of 68 cents per share, which topped analysts' estimates of 56 cents per share. The company attributed the strong quarter to a rebound in their theme parks. Shares of DIS jumped over 5% on the news. Cisco also reported this week, beating analysts' earnings estimates of 35 cents per share versus a reported 37 cents per share. Despite the beat, Cisco's product development and marketing expenses rose more than expected, sending shares of CSCO 14% lower.

CORPORATE BONDS

- Investment grade primary activity was light once again this week. Earnings black out and elevated Treasury rates likely kept many issuers on the sidelines. Those issuers who accessed the market experienced strong demand. Earnings remain mostly positive, but outlooks continue to weigh on the

market. Secondary market activity was strong as evidenced by the continued tightening of spreads. Notable deals this week included Telefonica ($2.75 billion), News Corp ($2.5 billion) and Wells Fargo ($2.5 billion).

- Investment grade corporate spreads continued to tighten week-over-week despite mixed earnings and economic data. Seasoned bonds were well bid throughout the week as investors use cash they set aside for new issuance to purchase bonds in the secondary market. The Barclays Credit Index Option-Adjusted Spread (OAS) finished the week at +131, tighter by seven basis points. Financials tightened by eleven basis points (banks -11, insurance -6); industrials tightened by six (basic materials -10, capital goods -6, telecom -7, consumer cyclical -5, consumer non-cyclical -4, energy -7); and utilities tightened by six basis points.

MORTGAGE-BACKED SECURITIES

- Agency mortgages performed favorably versus Treasuries but lagged credit as interest rates oscillated in a narrow range. On Friday, the Obama Administration unveiled a long-awaited white paper to limit the scope of the government in the U.S. mortgage market and gradually wind down Fannie Mae and Freddie Mac. The proposal offers three different options of government involvement in mortgage finance for Congress to evaluate and debate. The market's response was cautious optimism as many recommendations should curtail supply and possibly limit a homeowners' propensity to refinance if guarantee fees are raised and/or loan-to-value ratios are lowered. The market also recognizes that any reform will take years to resolve given the fragile state of the housing market. Within the mortgage market, the premium assigned to the 'full, faith, and credit' guarantee lifted Ginnie Mae mortgage premiums over conventionals. Higher coupon mortgages also outperformed lower coupons as higher mortgage rates should hinder refinance activity. In mortgage credit, the non-agency mortgage market was relatively quiet as investors congregated in Florida for the annual Asset Securitization Forum. Commercial mortgages posted strong returns from tighter spreads as the market warmed to $5 billion in new CMBS issuance.

- For the week, the 30-year current coupon versus the 10-year Treasury spread widened four basis points to 78 bps. According to Freddie Mac, thirty-year mortgage rates jumped above five percent for the first time since the spring of 2010.

MUNICIPAL BONDS

- The municipal market took its cue from the U.S. Treasury market this week, with a very light new issue calendar and reduced mutual fund flows. Issuers have been hesitant to market new deals in the post-BAB world, with the 30-day forward calendar only around $8 billion and dominated by Illinois' scheduled G.O. issue of $3.7 billion next week. South Carolina (Aaa/AA+) was the benchmark deal this week, issuing over $200 million in general obligation debt through competitive auction.

- As a precursor to potential future ratings actions, Standard and Poor's downgraded the State of New Jersey's GO debt one notch from AA to AA-, driven by the long-term threat of its underfunded pension funds. New Jersey has one of the most underfunded pensions in the country, and the ratings agencies have recently begun a review of state pension and OPEB liabilities with a view to potentially increase their weighting in the ratings decision. Market action on the news has been negligible, as market participants seem to have already factored in New Jersey's pension situation.

HIGH-YIELD BONDS

- The high yield market has retained its buoyancy despite the back-up in U.S. Treasury rates this week, which saw the ten year U.S. Treasury briefly exceed 3.7%. The high yield market is taking direction from the generally positive U.S. economic data and rallying equity markets and has been largely oblivious to recent interest rate moves. In February so far, the Merrill Lynch BB/B high yield index is up 0.65%, after a 1.9% return in January 2011. Market liquidity is healthy, with a number of billion dollar deals pricing this week. Mega deals pricing this week included billion dollar financings from serial high yield issuers

Chesapeake Energy, one of the largest U.S. gas producers, and Ally Financial, formerly GMAC, the large automotive finance company. Avaya Inc., the major U.S. telecommunication equipment provider, issued $1 billion of 8-year bonds rated B with a 7% coupon. Over $6 billion in deals were issued this week and while some of the deals did not trade up 2-3% in the secondary market as they have in past few weeks, the market tone in general is still strong.

INTERNATIONAL MARKETS:

EASTERN EUROPEAN EQUITIES

- The CECE index of equities traded in Central Europe (Czech Republic, Hungary, and Poland) lost -2.15% over the past week, while the Russian stock market was down -2.4%.

- In a "showcase" of divergent growth stories in Eastern Europe, Hungary's Industrial Production (IP) declined by -11.8% in December, while IP in Turkey was up +16.9% for the same month. The decline in Hungary was the largest since the 2008 financial crisis and was probably driven by weaker exports to Germany, which also recorded a weaker IP. In Turkey, stocks rallied after IP surpassed consensus expectations, while some questioned whether the fast pace of economic growth in the country may be showing signs of overheating.

GLOBAL BONDS AND CURRENCIES

- While major European and UK sovereign debt markets were quiet on the week, European peripheral concerns came to the surface again. Investors grew anxious that EU leaders would fail to agree upon plans to bolster the Eurozone's bailout fund and improve economic coordination. Therefore, although Portugal's €3.5 billion 5-year bond issue was initially well received on Monday, by Wednesday its cost of borrowing had risen to a record 7.35% on its 10 year bond and compelled the ECB to intervene on Thursday by buying Portuguese debt.

- Core government bond markets remained unchanged on the week. Even a sharp fall (1.5%) in German industrial production numbers did not move Bunds. Investors considered the weather and seasonality as key reasons for the decline and concluded that Europe's strongest economy is not weakening. As widely expected, the Bank of England's Monetary Policy Committee kept the base rate on hold in the UK, although the general market view is that they will raise rates by mid-year.

- In currency markets, the U.S. dollar continued to gain strength over the week against all the major crosses, supported by rising Treasury yields and jobless claims data that were significantly better than expected. The People's Bank of China moved to raise its one-year deposit and lending rate by 0.25% to 3% on Tuesday. Inflation worries in China combined with droughts in north-western Australia to weigh upon the Australian dollar, which ended the week down almost 1.6% versus the U.S. dollar. The New Zealand dollar also fell versus the greenback as their finance minister, Bill English, admitted the economy may have slid back into recession.

EMERGING-MARKET BONDS

- Emerging market dollar-pay debt spreads were tighter this week.

- Brazil's finance minister announced that the country will seek to cut 50 billion reais ($30 billion, or 1.5% of GDP) from the budget to keep the country's deficit from deteriorating and prevent further price pressures in the economy as inflation hit its highest level in at least two years in January. Consumer inflation rose 0.83% last month, or 5.99% versus last year, above market expectations.

- Egyptian President Mubarak stepped down after weeks of protest. Mubarak's attempt to hold on to power by transferring some authority to Vice President Suleiman appeared to backfire yesterday, as protesters refused to let down until their main condition is satisfied. It is expected that the military will temporarily take over government in the country until elections are organized later in the year.

NEXT WEEK'S ECONOMIC RELEASES

February 15	*Retail Sales, Empire State Index, Import and Export Prices, Business Inventories, NAHB Housing Market Index, ABC Consumer Comfort*
February 16	*Producer Prices, Housing Starts and Building Permits, Industrial Production, Capacity Utilization, FOMC Minutes*
February 17	*Initial Claims, Consumer Prices, Philadelphia Fed Index, Leading Indicators*