VANDERBILT Ave. ASSET MANAGEMENT

1st Quarter 2013

VAAM's economic forecast continues to foresee stronger growth than the consensus outlook. The economy will continue to grow, albeit slowly and inconsistently, until it gathers some momentum the second-half of the year. We are forecasting growth of 3.0% by the fourth-quarter. We do not foresee inflation being a problem. Although the recession ended in mid 2009, spare capacity remains large by historical standards. Our forecast of greater economic momentum is against a backdrop of real GDP of 0.4% for the fourth-quarter of 2012. This level in economic growth is somewhat misleading as real final sales were up 1.9%. Inventory restocking in future quarters will add to aggregate GDP. The consumer sector increased 1.8% for the quarter. A resurgent housing market is giving support to the consumer sector and the overall economy. Continued low mortgage rates encourage not only new purchases but also refinancing of higher rate mortgages. Quantitative easing by the Federal Reserve through the purchase of mortgage-backed securities is an additional support to low mortgage rates. In addition, the housing market has also been helped by a relatively low inventory of homes available for sale. While housing is a relatively small part of the overall economy, it is a large employer and housing prices have a significant impact on consumer confidence. A more buoyant consumer is reflected in improved sales for autos (March sales were the highest since 2007) and the retail sector which are important to the overall economy due to their multiplier effects. However, capital spending remains muted with isolated pockets of strength. For example, the petrochemical industry is embarking on a capital spending program as large as we've seen in decades. Companies are taking advantage of the significant availability of natural gas and liquids, a result of the shale development going on across the country which we think is transformative. The US economy has the potential to surprise on the upside.

The Federal Reserve has tied continued monetary easing directly to the unemployment rate with a target of 6.5% (versus 7.6% currently). The Fed is looking for a sustained improvement in the labor market before considering any moderation in their policy thus ensuring a continued easy monetary policy for the foreseeable future. While fiscal policy has recently been dominated with the sequestration implementation, the debt ceiling limit the latter-half of May is more relevant. The negotiation revolving around the debt ceiling may afford an indication of whether a broader compromise is possible with regard to reforming the tax code, raising overall revenues and addressing entitlement programs. Corporate executives will also respond positively in terms of capital expenditures as they begin, hopefully, to see some clarity in Washington and some stability in the global market.

During the quarter, the yield curve slightly steepened as long rates rose more than the shorter end of the market. The following outlines interest rate changes for the first-quarter:

	31-Dec	31-Mar	Change
3-monthTreasury Bills	0.04	0.07	0.03
6-month Treasury Bills	0.11	0.10	-0.01
2-year Treasury Note	0.25	0.24	-0.01
5-year Treasury Note	0.72	0.76	0.04
10-year Treasury Note	1.78	1.85	0.07
30-year Treasury Note	2.95	3.10	0.15
10-year vs. 2-year	151	161	10

Corporate Securities

The U.S. corporate bond market continued to provide stronger performance than the other sectors of the bond market during the first quarter of the year. The sector benefited from both a modest tightening in spreads and its higher yield. Financial companies were the best performing sector lead by the life insurance and brokerage group.

Electric utilities also outpaced the overall corporate market. On the downside, industrial bonds underperformed comparable U.S. Treasury bonds. The results were broad based across the industrial sector and driven by a number of factors including worries over a global slowdown that adversely impacted demand for economically sensitive companies such as mining and energy. Also shareholder friendly activities including debt financed stock buy-backs, dividend increases and LBOs hurt certain bonds. LBOs remain the largest risk in the corporate bond market. Announcements from Dell and Heinz highlight this risk.

Corporate bonds remain overweight in our portfolios. This position is supported by solid financial fundamentals, potential for modest spread tightening and the higher yield of the sector versus Treasury securities. During the fourth-quarter, over 70% of S&P 500 companies reported better than expected or in line earnings. Cash flow and debt levels are still supportive as they remain near all time best levels. In addition, our quantitative screen, that incorporates equity prices, volatility and debt levels to predict a fair value for a company's debt, remains positive. Therefore, our view from the beginning of the year is still relevant. Credit spreads are likely to modestly tighten over the course of the year and in combination with their higher yield will result in corporate bonds providing attractive incremental returns for our portfolios.

In our last report, we highlighted several names and industries. Events in the past quarter have not altered our general views. Goldman Sachs and Morgan Stanley, two stellar performers during the past three months, remain in our portfolios as their financial fundamentals continue to recover. Morgan Stanley is completing their purchase of Citibank's wealth management group which will provide stable, less risky revenue and an earnings base for the company. Their spreads remain elevated versus fair value. Lower quality insurance companies remain underweighted in our portfolios due to our concern over ongoing compression in their asset returns versus liability costs. Even though this view hurt relative performance, we believe that their long-term financial fundamentals do not support an investment at this time. Within the industrial sector, Freeport McMoran, a diversified mining company, was one of our top performing holdings. Our bottom up investment process identified Freeport as an attractive investment opportunity. Cash flow is strong as EBITDA-to-Interest exceeds 25 times, EBITDA-to-Debt is just 0.5 times and debt is almost entirely covered by cash on their balance sheet. Earnings were also positive during the past quarter. The combination of strong financial fundamentals and attractive pricing support this investment.

Mortgage-Backed Securities

Mortgage-Backed Securities (MBS) slightly underperformed comparable U.S. Treasuries during the first quarter. In the March 2013 FOMC minutes, the Federal Reserve announced its continuation of purchases of $40 billion of MBS and $45 billion of Treasuries per month. This policy should keep MBS spreads in a relatively tight range.

We decreased modestly our overall exposure to MBS during the first quarter, as the yield benefit afforded by this asset class has diminished somewhat. Our portfolios include both FNMA & FHLMC securities. We continue to favor the shorter maturities due to their modest durations, relatively stable prepayments and more predictable cash flows given a wide range of potential interest rate scenarios.

Despite some recent signs of economic improvement (i.e. housing), the Federal Reserve continues to support its policy of low interest rates. While MBS should continue to benefit from this stable and low-volatility interest rate environment in the near term, it is unclear how much longer this will last. We continue to monitor global economic and political developments which may impact the U.S. MBS market and will continue to invest in the best relative value opportunities for our portfolios-i.e. highest OAS, best overall yield, stable prepayments and good liquidity.