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Fixed Income Analysis

Situation

Overview

- The Sanibel General Employees' Pension Fund has 30 percent allocation to fixed income.
- Due to the extraordinary measures taken by the Federal Reserve Bank, interest rate is at historically lows.
- As interest rate rise due to inflationary expectations and tightening monetary policy, bond valuations are expected to decline.

Problem

- How do you substitute fixed income with other asset classes, without increasing the overall risk profile of the pension plan?

Solutions

- Lower the duration.
- Identify low volatility substitutes.
- Reduce fixed income exposure.



Analysis

- Rising interest rates are associated with inflation expectations, as investors demand higher nominal yields to capture the same real (after inflation) yields. A bond portfolio's sensitivity to interest rate change is measured by duration. A 4-year duration portfolio having a 4.5% yield would be expected to earn +0.5% during a 1% rise in rates.
- TIPS will perform better than bonds if rising rates are associated with increased inflation (CPI).
- Short-term bonds (1-3 year) having a lower duration would perform better than intermediate-term bonds as rates rise.
- High yield bonds would perform better than investment grade bonds, especially during periods of narrowing yield spreads, but not during times of market duress.
- Private real estate returns have a slightly negative correlation to investment grade and high yield bond.



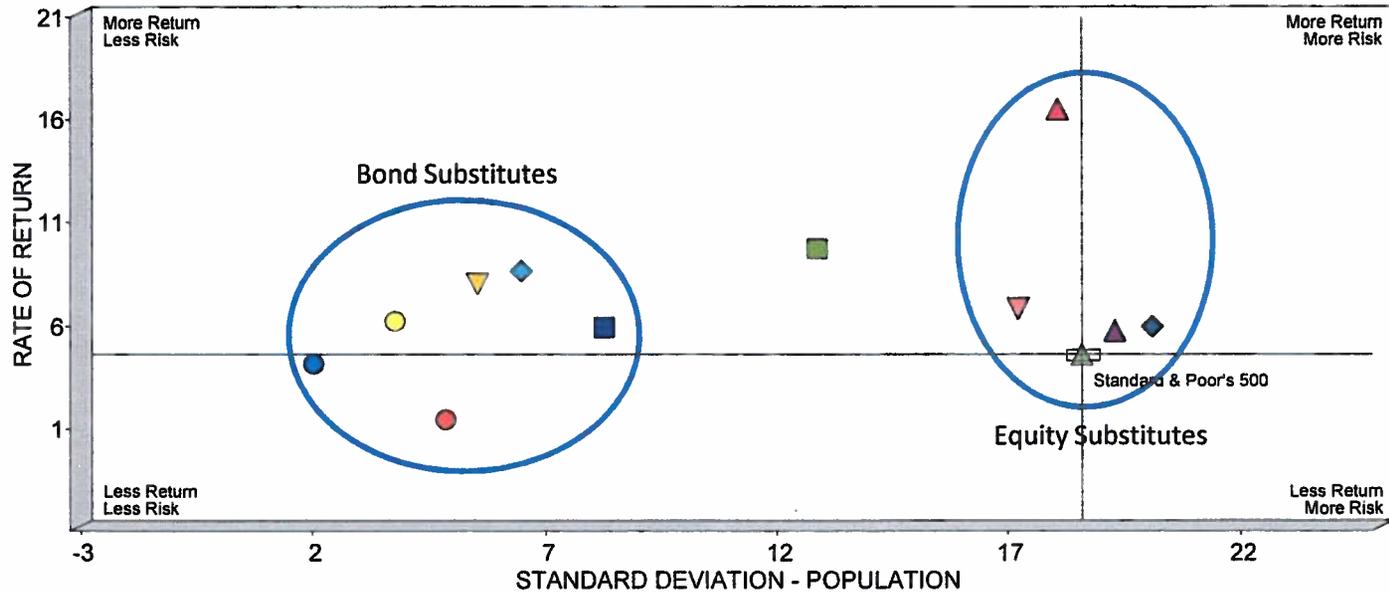
Correlation

Description	#	1	2	3	4	5	6	7	8	9	10	11	12
Alerian MLP Index	1	1.00											
Barclays 1-3 Year Govt/Credit	2	-0.19	1.00										
Barclays High Yield US Corporate	3	0.84	-0.17	1.00									
Barclays US Treasury Inflation Notes	4	0.20	0.51	0.14	1.00								
Dow Jones UBS Commodity Index	5	0.55	-0.13	0.52	0.24	1.00							
Dow Jones U.S. Select Dividend	6	0.49	-0.26	0.59	-0.22	0.22	1.00						
HFRX (Hedge Fund) Absolute Return Index	7	0.55	-0.25	0.42	0.15	0.62	0.28	1.00					
Merrill Lynch Invest Grade US Convert Bonds	8	0.65	-0.10	0.78	-0.03	0.49	0.47	0.40	1.00				
MSCI US IMI/Utilities	9	0.64	-0.26	0.59	-0.06	0.44	0.61	0.42	0.53	1.00			
NCREIF National Property Index	10	0.04	-0.23	-0.05	0.06	0.30	0.28	0.52	-0.10	0.29	1.00		
Standard & Poor's 500	11	0.66	-0.34	0.79	-0.20	0.44	0.85	0.46	0.81	0.73	0.24	1.00	
Barclays Aggregate	12	-0.09	0.81	-0.12	0.63	-0.23	-0.17	-0.31	-0.17	-0.10	-0.17	-0.33	1.00



Source: PSN (March 2002 – March 2012)

Risk / Reward



	ROR	Std Dev Pop	Alpha	Beta	R-Squared
▲ Alenax MLP Index	15.99	17.82	12.95	0.64	0.44
● Barclays 1-3 Year Govt/Credit	3.66	1.77	2.00	-0.03	0.09
■ Barclays High Yield US Corporate	9.24	12.63	5.89	0.55	0.62
▼ Barclays US Treasury Inflation Notes	7.51	5.32	6.04	-0.05	0.03
◆ Dow Jones UBS Commodity Index	5.49	19.86	3.91	0.47	0.19
▲ Dow Jones U.S. Select Dividend	5.29	19.07	1.75	0.89	0.73
● HFRX Absolute Return Index	1.02	4.62	-1.09	0.11	0.23
■ Merrill Lynch Invest Grade US Convert Bonds	5.40	8.03	2.44	0.36	0.65
▼ MSCI US IM/Utilities	6.30	16.96	3.21	0.67	0.54
◆ NCREIF National Property Index	8.17	6.25	6.21	0.08	0.06
▲ Standard & Poor's 500	4.12	18.35	0.00	1.00	1.00
● Barclays Aggregate	5.80	3.50	4.28	-0.06	0.09



Source: PSN (March 2002 – March 2012)

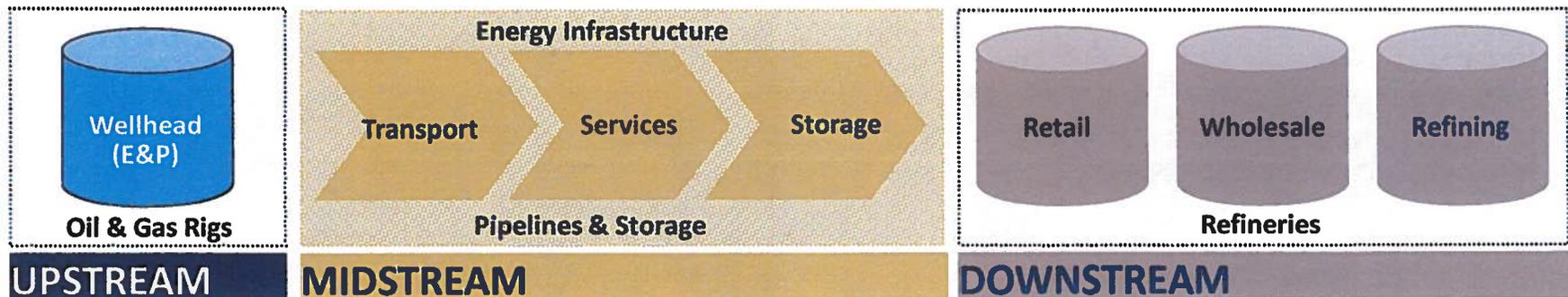
MLP Analysis



MLP Investments

Most managers prefers to invest in Energy Infrastructure (Midstream)

Approximately \$200 Billion & 75 issues.



Midstream activities include **gathering** (moving crude oil or raw natural gas via low pressure pipelines to plants for processing) **dehydration & treating** of natural gas; gas **processing & fractionation**; oil & natural gas **storage**; and **transportation**

Why Midstream assets (largest of the 3 segments):

- Stable cash flows
- Durability of cash flows
- Delinkage to commodities
- Tenure of contracts





Asset Category Stress Test MLP, Stocks & Bonds

Period: 12/2001-12/2011

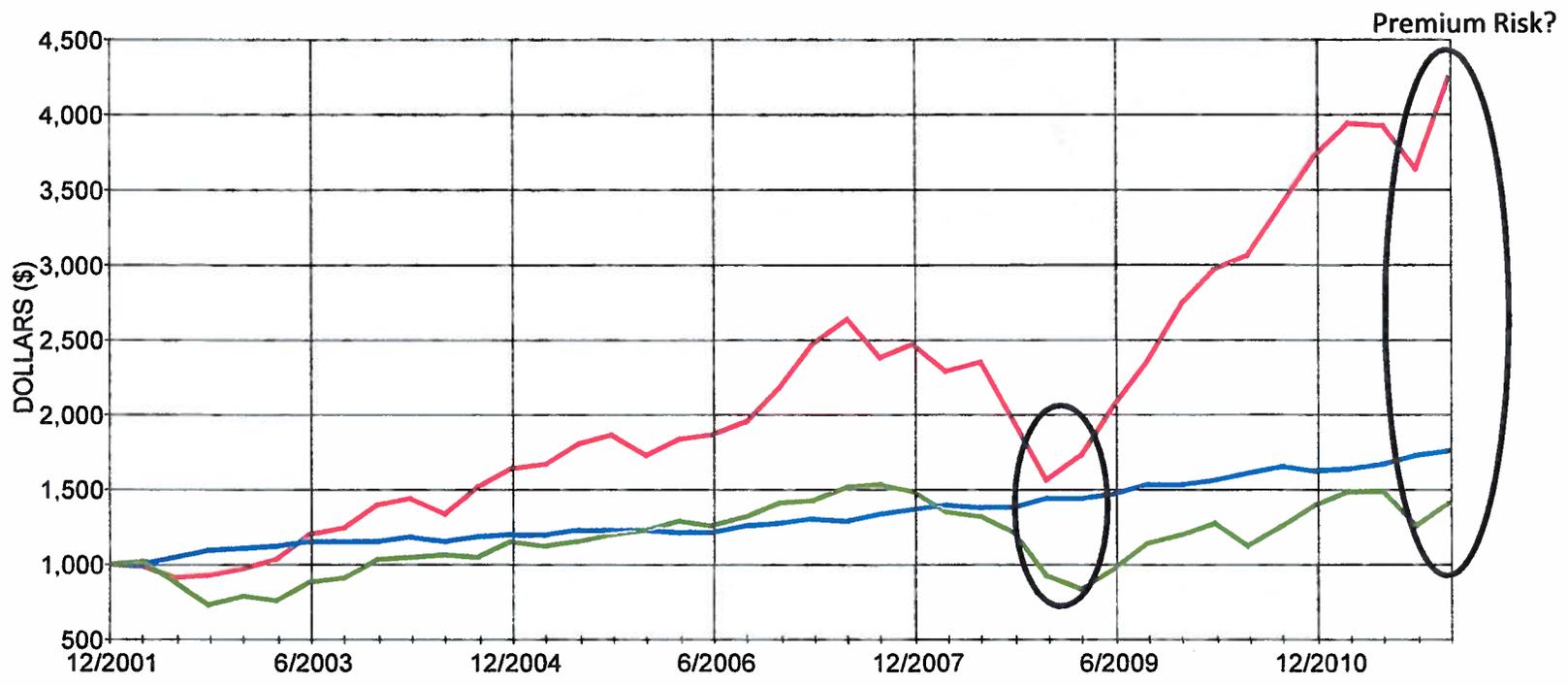
	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002
Best	Alerian MLP Index	Alerian MLP Index	Alerian MLP Index	Barclays Agg Index	Alerian MLP Index	Alerian MLP Index	Alerian MLP Index	Alerian MLP Index	Alerian MLP Index	Barclays Agg Index
	13.86	35.85	76.45	5.24	12.74	26.06	6.32	16.67	44.54	10.27
	Barclays Agg Index	Rus 3000 Index	Rus 3000 Index	Alerian MLP Index	Barclays Agg Index	Rus 3000 Index	Rus 3000 Index	Rus 3000 Index	Rus 3000 Index	Alerian MLP Index
	7.84	16.93	28.34	-36.93	6.96	15.72	6.12	11.95	31.06	-3.37
Worst	Rus 3000 Index	Barclays Agg Index	Barclays Agg Index	Rus 3000 Index	Rus 3000 Index	Barclays Agg Index	Barclays Agg Index	Barclays Agg Index	Barclays Agg Index	Rus 3000 Index
	1.03	6.54	5.93	-37.31	5.14	4.33	2.43	4.34	4.11	-21.54

Best/Worst Returns
Period: 12/2001-12/2011 Rolling 3 Years

	2011	2010	2009	2008	2007	2006	2005	2004	2003	2002
Best	Rus 3000 Index	Rus 3000 Index	Alerian MLP Index	Alerian MLP Index	Alerian MLP Index	Alerian MLP Index	Alerian MLP Index	Rus 3000 Index	Rus 3000 Index	Rus 3000 Index
	3.34	23.74	25.07	20.25	12.52	12.24	13.04	18.81	22.35	21.14
	Alerian MLP Index	Alerian MLP Index	Rus 3000 Index	Rus 3000 Index	Rus 3000 Index	Rus 3000 Index	Rus 3000 Index	Alerian MLP Index	Alerian MLP Index	Alerian MLP Index
	21.02	23.62	24.4	15.82	7.51	8.66	11.30	13.57	12.63	16.06
Worst	Barclays Agg Index									
	3.34	3.67	3.38	3.56	3.08	3.54	3.19	3.66	3.51	3.37



Growth of an Investment MLP, Stocks & Bonds December 2001 – December 2011

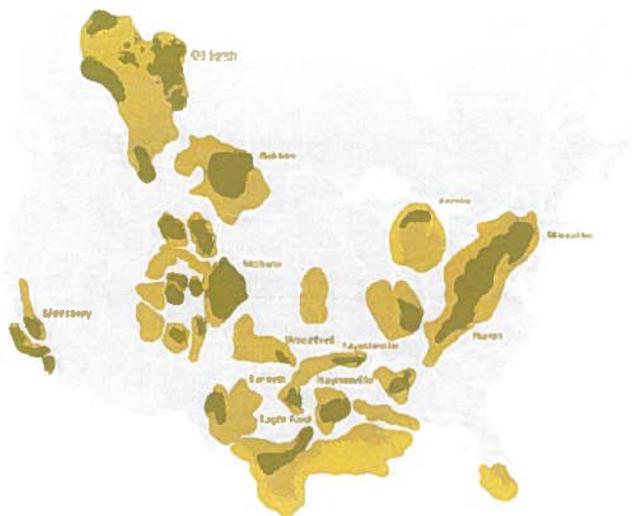
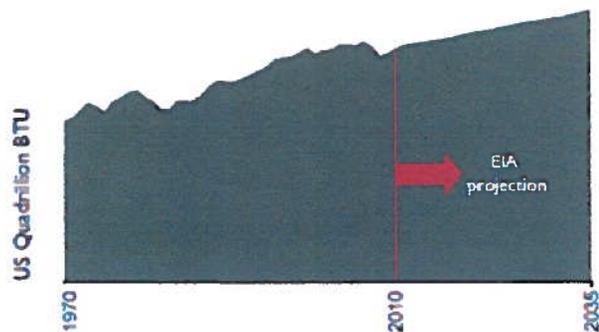


	Latest Quarter	1 Year	2 Years	3 Years	5 Years	10 Years
Alerian MLP Index	1,163	1,139	1,547	2,729	1,941	4,239
Barclays Capital Aggregate	1,011	1,078	1,149	1,217	1,370	1,754
Russell 3000	1,121	1,010	1,181	1,516	999	1,413

- Yield spreads are +100 bps above BBB rated bonds.
- Yield spreads are +400 bps above Treasuries.



MLP Analysis Growth Drivers



Source: Energy Information Administration, Credit Suisse and TCA estimates

Demand Growth

- US consumption follows population growth
- Relatively inelastic demand
- Producer Price Index (PPI) escalators adjust certain tariffs

Organic Growth

- ~\$20 billion in new projects expected 2011-13
- Long-term impact of shale gas supply basin build-out
- Necessary upgrades to existing system

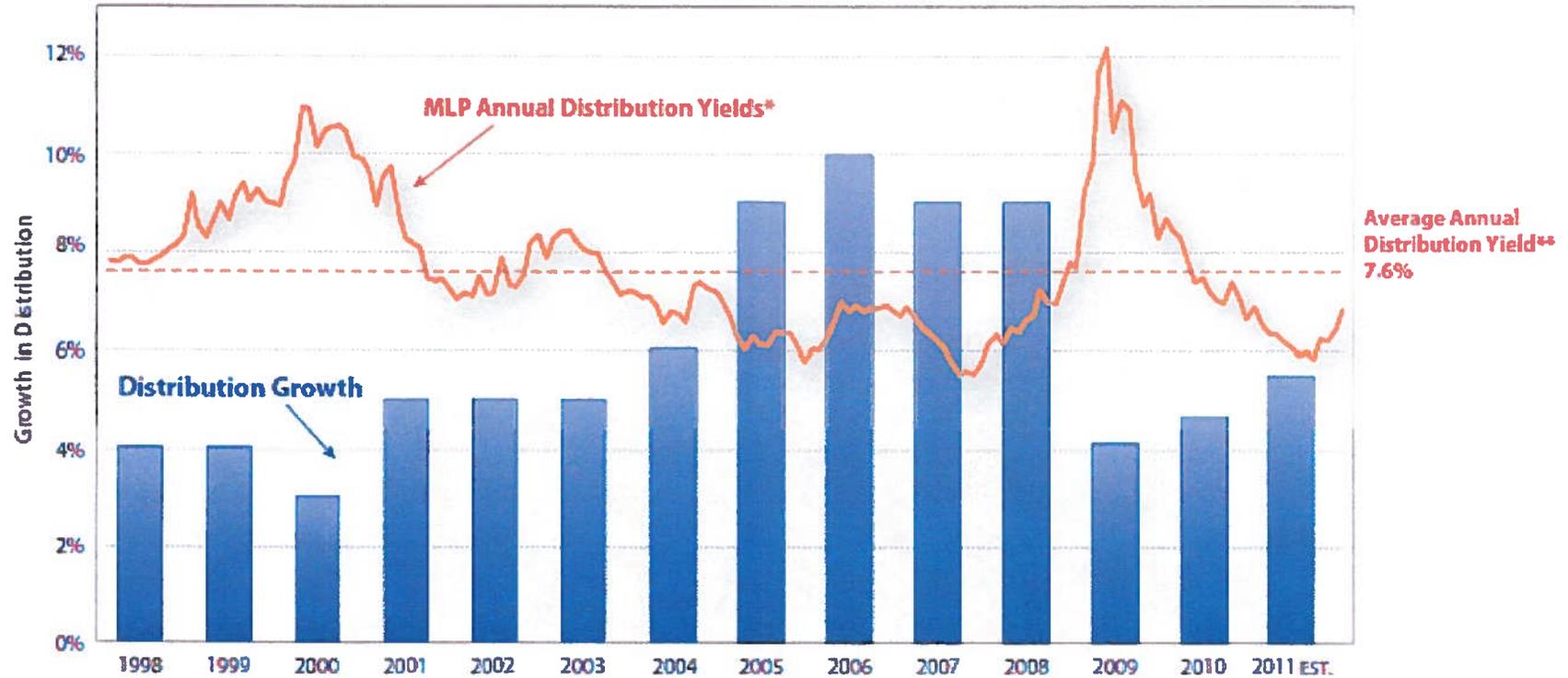
M&A Growth

- ~\$35 billion in new acquisitions expected in 2011-13
- MLPs own approximately 50% of assets suitable for the structure
- Integrated energy companies motivated to migrate assets into tax efficient structure.



MLP Analysis Distribution Yield

Growth of Annual Distributions—Alerian MLP Index



* This is not the total distribution but the percentage of increase in distributions each year. Source: Citi January 2009, and Wells Fargo Securities MLP Monthly January 2010
** Yield taken from January 31, 1998 through August 8, 2011. Dividend yield is only one component of total return. Past performance is not a guarantee of future returns.
See important disclosures and definitions at end of presentation. Created with Zephyr StyleADVISOR.



MLP Equity Issuance & Benchmark Characteristics

Alerian Index Sectors

- Petroleum Transportation 42.8%
- Natural Gas Pipelines 32.0
- Gathering & Processing 24.4
- Other | Refining 0.8

Alerian Index Characteristics

- No. of Companies 25
- Market Capitalization \$160 BB
 - Medium Market Cap \$3.6 BB
- Weight of Top 10 Holdings 65.7%

MLP Equity Issuances



MLP Debt Issuances



Source: UBS



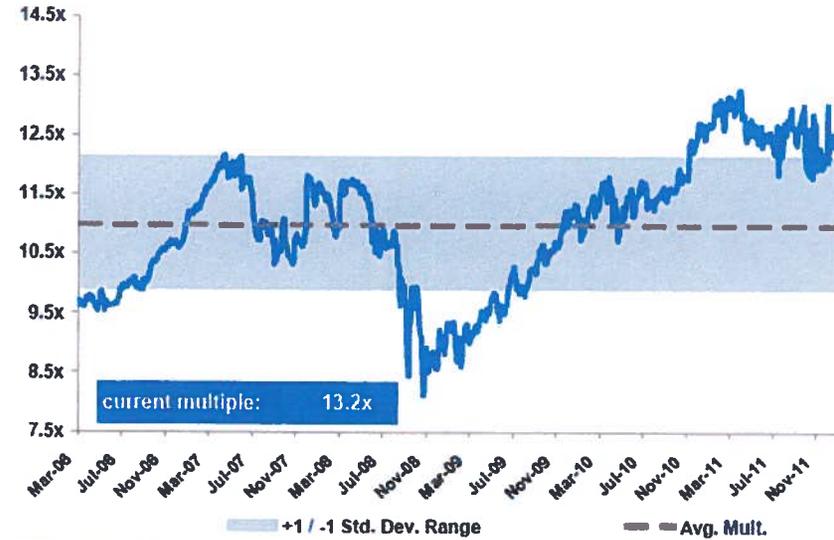
MLP Investment Vehicles

Investment Option	Tax Classification	Avoids Double-Taxation ¹	Portion of Income Received as Return of Capital ²	Tax Reporting	Active Management
Managed Account (SMA)	Partnership	Yes	Yes	K-1	Yes
Direct MLP Investment	Partnership	Yes	Yes	K-1	No
Closed-End Fund-Corporation	Taxable Corporation	No	No	1099	Yes
Open-End MLP Mutual Fund: Corporation	Taxable Corporation	No	No	1099	Yes
Exchange-Trade Fund (ETF): Corporation	Taxable Corporation	No	No	1099	No
Exchange-Traded Note (ETN)	Prepaid Forward Contract	Yes	No	1099	No

- Most suitable investment vehicle for tax-exempt institutions: Managed Account
- Most suitable investment vehicle for taxable institutions: Closed-end, Open-end or Exchange Traded Fund.

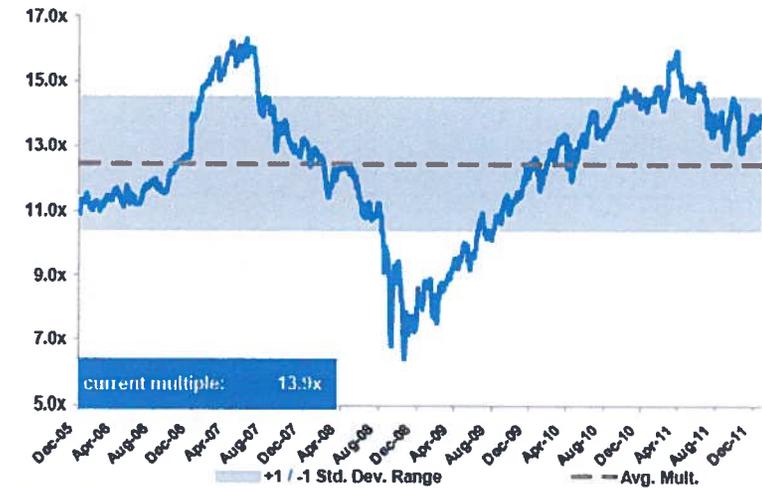
Exhibits

EV/EBITDA Multiple Screens Elevated Currently



Source: Company data, Morgan Stanley Research

MLP P/DCF Multiple (forward four quarters) MLPs are trading above historical average



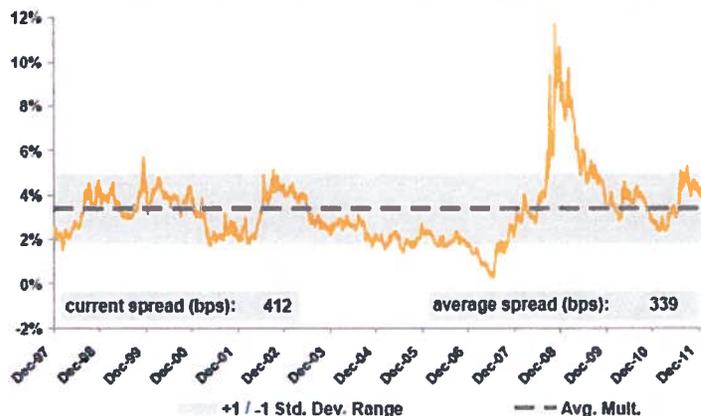
Source: Company data, Morgan Stanley Research



Exhibits

MLP Yields / 10-Yr Treasury Spread

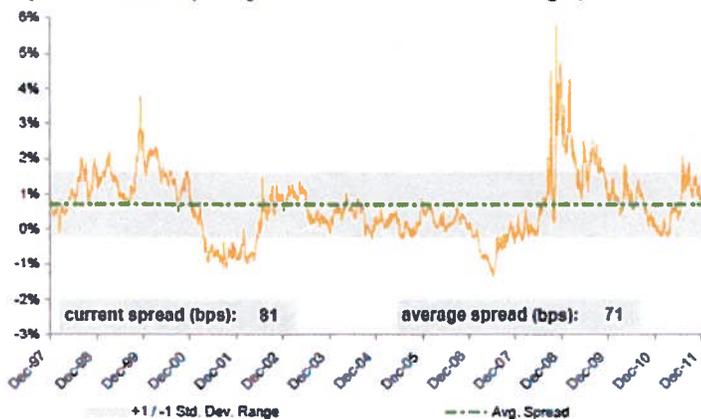
Less relevant as of late given MLP growth potential



Source: Company data, Morgan Stanley Research

MLP Yields Closely Track Baa Bonds

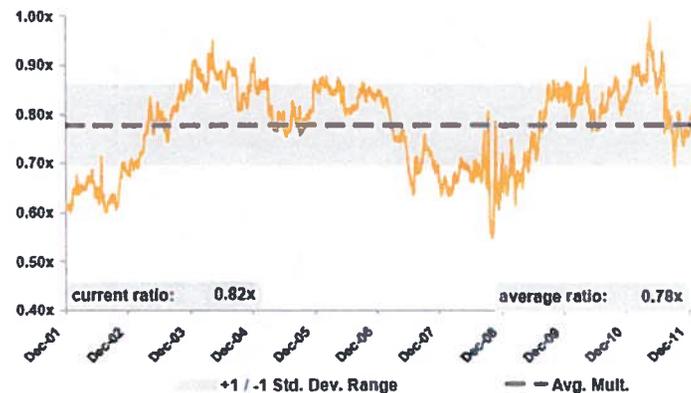
Top 50 MLPs (not just MS under coverage)



Source: Company data, Morgan Stanley Research

MLP / High Yield Index Ratio

A higher ratio indicates MLP yields are cheaper (on a relative basis)



Source: Company data, Morgan Stanley Research



Potential Risks

Investment Risk: Equity like volatility

Liquidity: Depends on the structure of the investment vehicle, MLP investments may be liquid.

Sector Risk: High concentration among the largest companies.

Geopolitical Risk: Investments are object to political influences.

Reinvestment Risk: Funds may be unable to find a sufficient number of attractive opportunities to meet their objectives. Time sensitive reinvestment risk applies.

Tax Risk: There are number of US Federal Income tax consequences. Investors should review them carefully.

Hedging: MLPs may choose to hedge interest rate, credit and other exposures. Investment managers may also choose to hedge similar risks.

Derivatives: Exchange and OTC options, CDS and total return swaps are used directly and indirectly, by the MLP and the investment manager.

Other: Managers may invest in private placements and other “alternative” & illiquid vehicles.

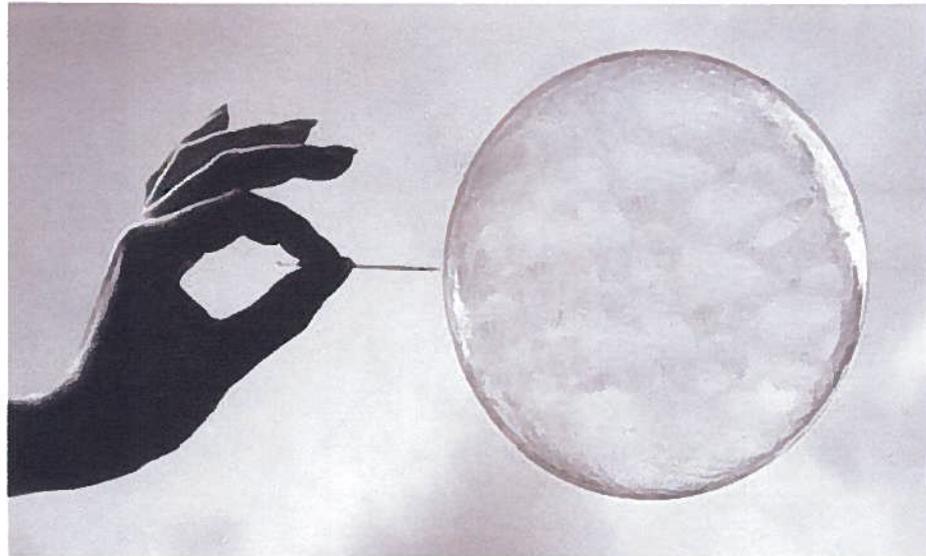
Definitions



Bond Alternatives

Other Asset Classes:

Absolute Return Strategies
CD, CDARS & Money Market
Commodities
Convertibles Securities
Direct Real Estate
Equity-Income
GIC
High Yield
TIPS & CIPS



Absolute Return Strategies

Absolute Return (Hedge Funds)

The manager of a hedge fund has the freedom to be long and/or short and to use the widest possible range of financial instruments to implement the investment strategy.

Popular Strategies:

- Relative Value / Arbitrage
- Equity Hedge (Long/Short)
- Global Macro
- Event Driven
- Trading



Certificate of Deposit (CD), CDARS & Money Market Securities

Certificate of Deposit (CD)

FDIC insures CDs up to \$250,000. CDs are illiquid during the life of the deposit.

CDARS

Certificate of Deposit Account Registry Service provides access to a pool of CDs and provides FDIC insurance greater than \$250,000.

Money Market Securities

MMKT securities are considered cash equivalents with a unit value of \$1.0. This investment vehicle is offered using a variety of investment quality securities, which determines the yield.

iMoneyNet Money Fund Averages™

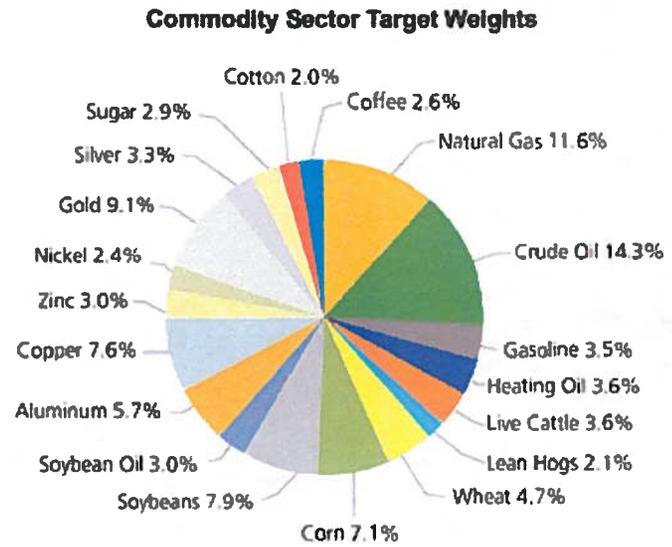
Taxable (01/11/11)	%	Tax-Free (01/10/11)	%
7-Day Net Simple	0.03	7-Day Net Simple	0.03
30-Day Net Simple	0.03	30-Day Net Simple	0.04
7-Day Net Compound	0.03	7-Day Net Compound	0.03
Assets (\$mils)	\$2,440,069.1	Assets (\$mils)	\$334,262.4
Assets as of last week (\$mils)	\$2,443,185.8	Assets as of last week (\$mils)	\$332,163.6
Assets % Change	(0.13)	Assets % Change	0.63



Commodities

Commodities

Commodities are real assets – such as natural resources, oil, precious metals, livestock, or raw agricultural products. Primary ownership is through collateralized commodities futures (CCF). Risks include: Monetary policy of central banks, geopolitical, currency, climate and environmental.

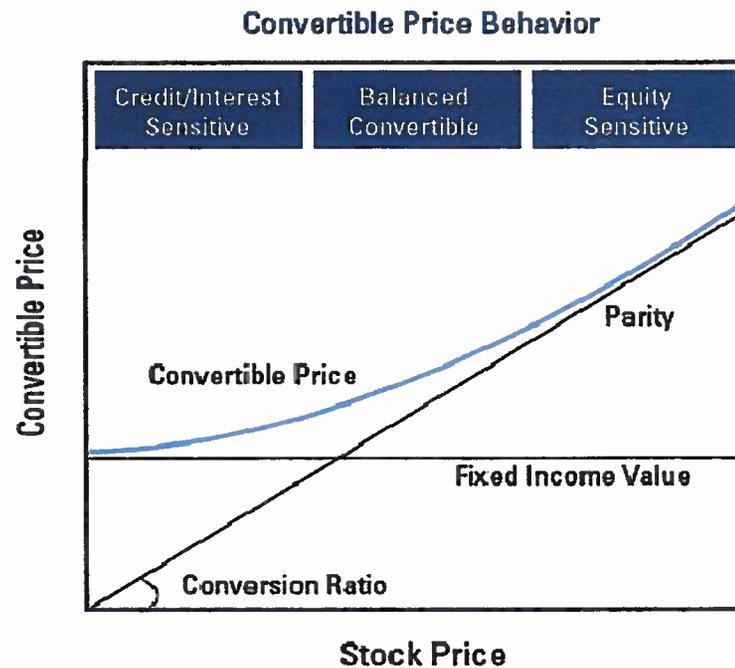


Source: Dow Jones UBS Commodities Index

Convertible Securities

Convertible Securities

Convertibles are instruments that may be converted into shares of common stock in the issuing company. It is a hybrid security with debt and equity like features.



Source: PIMCO



Direct Real Estate

Direct Real Estate

Direct real estate can be purchased through open and close-ended funds, and private placements. The goal is to own a diversified pool of commercial income producing properties. The total return is determined by the capital appreciation and income. These properties are often valued on a quarterly basis. Other risks: leverage and liquidity.

Commercial Sectors:

- Residential
- Office
- Industrial
- Retail
- Hotel



Equity Income

Equity Income

An investment strategy that focuses on high-quality companies with reliable history of dividend payments and growth in the dividend rate. The equity income securities are highly correlated (+0.80) to the general equity market.

Equity Income Assets:

- Utilities (Electric, water, Telecom, etc.)
- Listed Infrastructure
- Real Estate Investment Trust (REIT)
- Master Limited Partnership (MLP)



Guaranteed Investment Certificate (GIC)

Guaranteed Investment Certificate (GIC)

Conventional GICs are investments with limited maturity (1-5 Years). However, the long term expected returns are less than stocks and bonds. GICs are often illiquid.



High Yield

High Yield

These investments are rated below investment grade with higher risk of default, but typically pay higher yields.

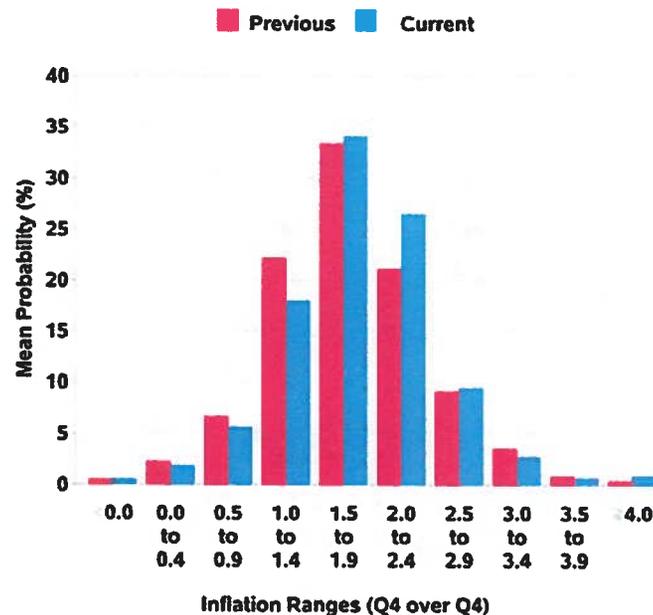


Treasury (or Corporate) Inflation Protect Securities (TIPS/CIPS)

Treasury / Corporate Inflation Protected Securities

Valuations linked to the Consumer Price Index. TIPS/CIPS may be held until maturity, or sold at any time in the secondary market. TIPS are guaranteed by the United States Treasury. The greatest risk occurs when interest rate rise with no inflation.

Mean Probabilities for Core PCE Inflation in 2012



Source: Philadelphia Fed

Summary

	Pros	Cons
Absolute Return Strategies	Nondirectional. Low correlation to equities.	Leverage & transparency.
CD, CDARS & Money Market	FDIC insurance, US. guaranteed return.	Liquidity & inflation risks.
Commodities	Inflation hedge. Diversification.	Monetary policy & environmental risks.
Convertible Securities	Stable income and option to convert.	Equity & default risk.
Direct Real Estate	Stable income. Tangible asset.	Liquidity. Valuation methods.
Equity-Income	Yield.	Volatility.
GIC	Limited maturity, guranteed return	Liquidity & company risk.
High Yield	High income.	Default, interest risk & volatility.
TIPS & CIPS	TIPS backed by U.S. government, linked to inflation.	Deflation.

