Our Perspective

MANAGING FIXED INCOME RISKS IN 2011

Understanding interest rate and credit risks // Evaluating your portfolio // How to take action

RAYMOND JAMES®

KEY TAKEAWAYS

Anticipated rising interest rates in the future may have a negative impact on the value of many fixed income investments.

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Credit quality of municipal and other types of bonds should be assessed within portfolios to determine if they remain aligned with your risk tolerance and investment objectives.

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Investors should work with their financial advisor to analyze the fixed income investments in their portfolio, reevaluate the role they play in their overall financial plan and consider strategies available to manage risks.

Fixed income securities have traditionally played a very important role in investors' portfolios and, just like the other aspects of a well maintained investment plan, they should be reviewed regularly to ensure their appropriateness. Today's market is presenting investors with a number of challenges that should be considered when evaluating their fixed income holdings, most predominantly interest rate and credit risks.

In this paper we'll discuss recent trends in fixed income, the risks present in today's market and a number of steps and strategies that can be taken to help address those risks.

RECENT HISTORY

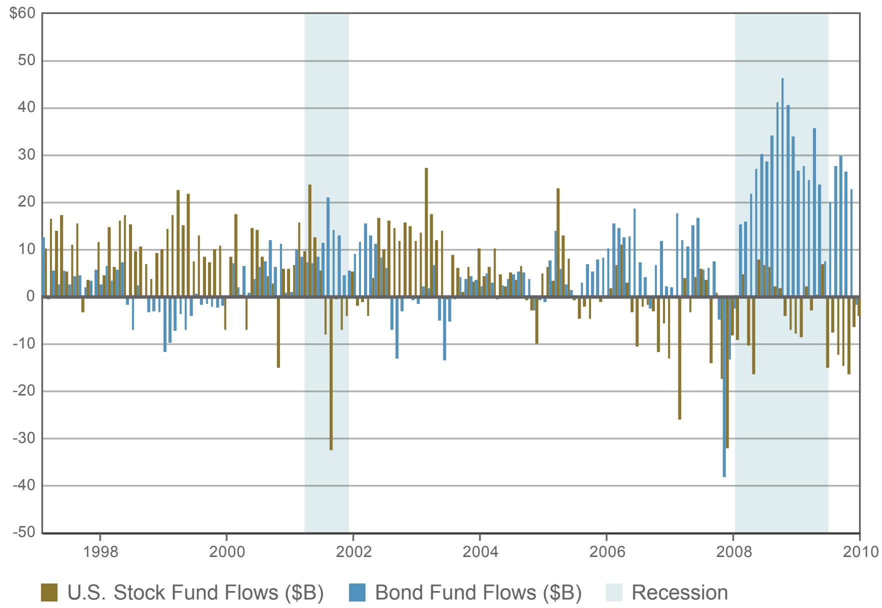
In retrospect, bonds have enjoyed a multi-decade rally since the early 1980s, when interest rates began their long steady decline from their all-time highs to near all-time lows. Over this period, the yield on 10-year U.S. Treasury bonds declined from a high of 15.84% in September of 1981 to 3.30% as of December 31, 2010, just off its December 2008 record low of 2.06%. During this cycle the Barclays Capital Aggregate Index* had an average annual return of 9.23%. It seems clear that it would be very difficult for these kinds of annualized returns to persist in the near future.

This performance combined with general risk aversion sparked by recent equity market volatility and an aging population seeking income during retirement caused investors to pour a record $376 billion of net new cash flows into bond funds in calendar year 2009. In 2010, bond funds saw an additional $246 billion of new cash flows, 95% of which went into taxable bond funds, according to Investment Company Institute.

U.S. Treasury Yield

*The Barclays Capital U.S. Aggregate Index represents securities that are SEC-registered, taxable and dollar denominated. The index covers the U.S. investment grade fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance.

Fund Flows



Source: Morningstar

Additionally, as interest rates continued to decline, many investors purchased longer duration and lower quality income alternatives to try and "stretch for yield." With interest rates currently near historic lows, where they have been for an extended period of time, the value of these bonds has held up relatively well. These actions are not without risk however, and investors should pay careful attention to the positioning of their portfolios going forward to avoid unexpected outcomes.

UNDERSTANDING WHY YOU OWN FIXED INCOME INVESTMENTS

Investors typically include fixed income in their portfolios for a variety of reasons: predictable income, diversification from equities, preservation of capital* or total return opportunities. Depending on the specific role fixed income investments play in your portfolio, the associated risk factors will have a different impact on your decision making process.

Ask yourself why you own bonds. Are they part of an overall asset allocation? Do I need them for income? Or are they simply a temporary parking place for investment funds as an alternative to low-yielding cash? Other important factors also impact your bond allocation, including your investment time horizon, risk tolerance and future goals. The "Why" is critical to working with your financial advisor to determine action steps.

*Holding bonds to maturity allows redemption at par value. However, if bonds are sold prior to maturity, proceeds may be more or less than your initial investment.

UNDERSTANDING TODAY'S RISKS

Interest rate risk

As economic conditions continue to improve, interest rates are likely to rise and investors may have reason to be concerned about potential declines in the value of their fixed income investments. Remember, as interest rates rise, bond prices typically decline and vice versa.

The following illustrates how a bond's value is reduced when interest rates rise. Conversely, the value would increase when rates fall. This example assumes a 4% coupon bond with a 4% yield at inception (priced at par: 100.0). If the market rate for like bonds went up to 5% (a 100 basis point change), the value of the bond would decline by the amount shown under "Change In Bond's Price/Value," with the "Ending Price/Value" listed in the final column.

Many investors, however, own individual bonds to receive steady, consistent income. Since these income-focused investors typically hold bonds to maturity when the par value is returned, subject to the creditworthiness of the issuer, they may not be as concerned about changes in the value of their bonds due to movement in interest rates. If investors do not need the income, and are instead using bonds to achieve an attractive total return, they may be more sensitive to losses and take other actions. This is why it is so important to work with your financial advisor to understand the role fixed income investments play in your portfolio.

Remember, as interest rates rise, bond prices typically decline and vice versa.

SENSITIVITY IN BOND PRICE TO CHANGES IN INTEREST RATES

BOND MATURITY (Years from today)	ORIGINAL PRICE/VALUE (4% bond purchased to yield 4%)	CHANGE IN BOND'S PRICE/VALUE (Per 100 basis points upward interest rate change*)	ENDING PRICE/VALUE (After 100 basis point interest rate change)
5 Years	100.0	4.4%	95.6
10 Years	100.0	7.8%	92.2
30 Years	100.0	15.5%	84.5

Note these are examples and approximations. This example assumes non-callable bonds. Callable bonds have different sensitivities when they are priced above 100.0.

*A basis point is 1/100 of 1%. A 100 basis point change would be when interest rates move 1 full percent, example moving from 4% to 5%. The change in value shown is specific to a 100 basis point rate change in similar securities. If the rate change was only 50 basis points, (or a 1/2% rate change), the value change would be roughly half of what is shown. By extension, if the rate change was 300 basis points, the change in value would be approximately 3 times what is shown.

What is duration?

In simple terms, modified duration gives an idea of how the price of a bond will be affected should interest rates change. A higher duration implies greater price sensitivity to changes in interest rates. Duration is quoted as the percentage change in price for each given percent change in interest rates. For example, the price of a bond with duration of two would be expected to decline by about 2.00% for each 1% move up in rates. On the other hand, the price of a bond with duration of 10 would be expected to decline 10% for the same 1% increase in rates.

The duration of a bond is primarily affected by its coupon rate, yield and remaining time to maturity. The following scenarios comparing two bonds should help clarify how these three traits affect a bond's duration:

- If the coupon and yield are the same, duration increases with time left to maturity
- If the maturity and yield are the same, duration increases with a lower coupon
- If the coupon and maturity are the same, duration increases with a lower yield

The effective duration of callable bonds trading at a premium may extend considerably if they begin trading at a discount.

For example, the price of a bond with duration of ten would be expected to decline by about 10.00% for each 1.00% move up in rates.

CREDIT RISK

The safety of your fixed income principal depends on the issuer's credit quality and ability to meet its financial obligations, such as payment of coupon and repayment of principal at maturity. Rating agencies assign ratings based on their analysis of the issuer's financial condition, economic and debt characteristics, and specific revenue sources securing the bond. Issuers with lower credit ratings usually offer higher yields to compensate for the additional credit risk.

It is important to note that credit risks aren't limited to an issuer declaring bankruptcy or missing a payment. A change in either the issuer's credit rating or the market's perception of the issuer's future prospects can affect the value of its outstanding securities and investors can see their bonds decline in price. Ratings are not a recommendation to buy, sell or hold, and may be subject to review, revision, suspension or reduction, and may be withdrawn at any time.

If a bond is insured, you should pay attention to the creditworthiness of the underlying issuer or obligor on the bond, as the insurance feature may not represent additional value in the marketplace nor contribute to the safety of principal and interest payments.

Current concerns with municipal bonds

The economic environment of the last several years has negatively impacted revenue streams for municipalities, creating concerns about and increased media focus on the ability of some municipal bond issuers to satisfy their debt obligations. Recently the struggles of certain municipalities have been highlighted in a variety of media outlets, with some industry pundits predicting broader disruptions and greater price volatility in the municipal bond market.

For these reasons, many municipal bondholders today are increasingly concerned that bond issuers may not be able to meet their obligations. Historically, however, highly rated municipal issuers have demonstrated excellent financial strength. They're generally considered second only to U.S. Treasury securities with respect to consistently satisfying their debt obligations and overall, that hasn't changed. Still, while most municipal bonds continue to exhibit a high degree of credit quality, the severity and longevity of the current U.S. economic slowdown has prompted some worries regarding potential credit deterioration, declines in valuation and possible interruption of interest payments.

The extended economic slump has negatively impacted many municipalities' core revenues including nearly across-the-board decreases in their income tax, sales tax, property tax and other revenues. At the same time, expenses and other financial obligations (such as pension obligations) have been difficult to reduce. The major rating agencies that evaluate the credit quality of municipal issuers and their bonds – Moody's, Standard & Poor's and Fitch – have been issuing rating downgrades on some municipal securities.

Included in these downgrades are many insured bonds that were rated AAA due to credit enhancement from a bond insurer prior to the financial crisis. Five years ago, more than half of the municipal market was issued with AAA ratings from insurance. In 2009, that number dwindled to less than 6%. Today, there are no longer any bond insurers that carry AAA ratings. Many municipal bonds now rely primarily or solely on their own credit strength for their bond rating.

RATING TABLE WITH DEFINITIONS

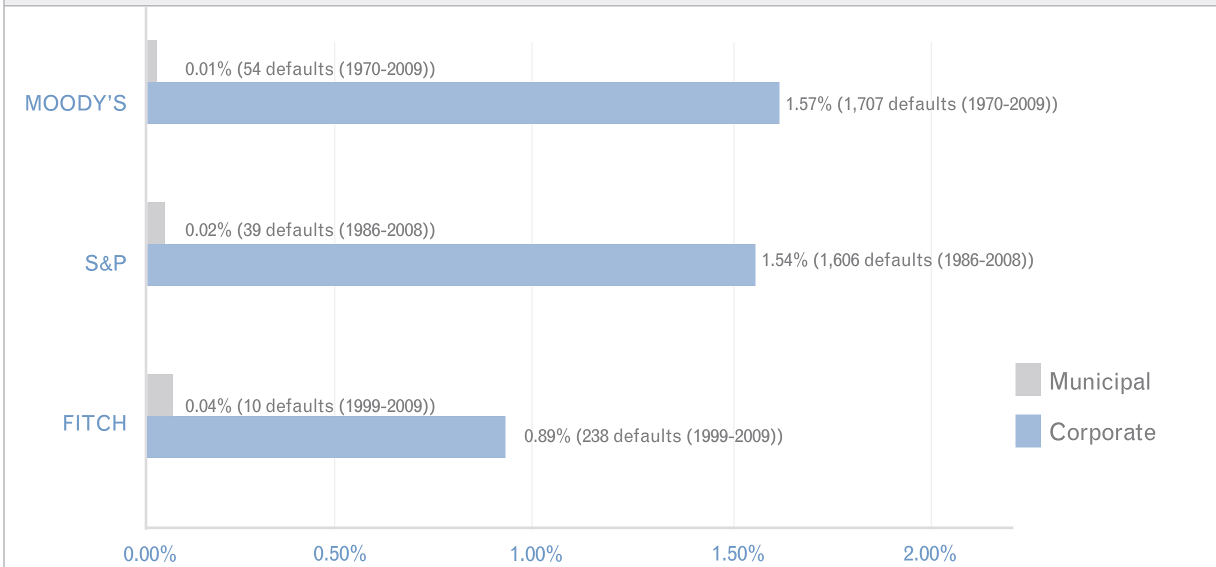
MOODY'S RATING	S&P RATING	DEFINITION
Aaa	AAA	Obligations rated Aaa are judged to be of the highest quality, with minimal credit risk.
Aa1 Aa2 Aa3	AA+ AA AA-	Obligations rated Aa are judged to be of high quality and are subject to very low credit risk.
A1 A2 A3	A+ A A-	Obligations rated A are considered upper-medium grade and are subject to low credit risk.
Baa1 Baa2 Baa3	BBB+ BBB BBB-	Obligations rated Baa are subject to moderate credit risk. They are considered medium grade and as such may possess certain speculative characteristics.
Ba1 Ba2 Ba3	BB+ BB BB-	Obligations rated Ba are judged to have speculative elements and are subject to substantial credit risk.

Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking, and the modifier 3 indicates a ranking in the lower end of that generic rating category. S&P ratings are modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories. Definition shown above is the Moody's rating definition. As you move up or down by one or two immediately adjacent columns, you are moving up or down a "notch".

As mentioned earlier, the press has painted a fairly alarming picture of the municipal credit landscape. While there is an emerging fear of defaults, this is historically a very rare occurrence in the municipal bond market. In fact, most municipalities raised fees and cut spending in areas of personnel and capital projects before they cut bond payments. Since these issuers rely on access to capital markets to raise money, defaulting on payments would impact their credit rating and consequently curb this source of funding. Default is truly a last resort due to its impact on future funding. Even if a municipality declares bankruptcy – there are severe limitations for many entities to even legally do so – it does not necessarily follow that it will default on interest payments.

The municipal bond market is highly diverse, comprised of more than 60,000 different issuers. Many bonds are susceptible to these areas of concern, but many others will be less affected. Credit strength and resiliency varies a great deal from bond to bond. We believe the diversity of the municipal market offers investors many choices, with plenty of options to help navigate today's environment.

RATED MUNICIPAL VS. CORPORATE DEFAULT RATES BY RATINGS SERVICE



1. Moody's Investors Services, U.S. Municipal Bond Defaults and Recoveries, 1970-2009 (February 2010); Moody's Investors ServCorporate Default and Recovery Rates, 1920-2009 (February 2010). Percentages based upon average one-year default rate.
2. Standard & Poors, 2009 Global Corporate Default Study and Ratings Transitions (March 17, 2010); Standard & Poor's; U.S. Municipal Ratings Transition and Defaults, 1986-2009 (March 11, 2009). Percentages based on average default rate.
3. Fitch Ratings Inc. U.S. Public Finance Transition and Default Study (1999-2009), March 25, 2010; Fitch Ratings Global Corporate Finance 2009 Transition and Default Study.

There are numerous other risks you should be aware of when investing in fixed income. For detailed information on factors to consider when investing in bonds, visit: **http://raymondjames.com/fixed_income.htm**

UNDERSTANDING FIXED INCOME OPTIONS: KNOW WHAT YOU OWN

When investing in bonds, you typically have three main options: Individual Bonds, Bond Funds and Managed Accounts. Each of these options has different characteristics and risk profiles so it is important to understand how each will be impacted by certain situations and how that will affect you given your reasons for owning bonds.

Individual bonds have long been the traditional option for fixed income investing but, for many, bond funds have become a popular choice for diversification and professional money management with a lesser required investment. Bonds may also be purchased as part of a Separately Managed Account (SMA), through which portfolio managers select bonds to be owned by the investor directly. Below is an overview of bonds and bond funds.

INVESTMENT CONSIDERATIONS	BONDS	BOND FUNDS
Income	Offer predictable income stream known at the time of purchase	Interest payments vary based on bonds that the fund's manager buys and sells, and on current market rates
Principal protection	The amount of principal (i.e., par value) that will be returned at maturity is known at the time of purchase subject to credit worthiness of the issuer	Since bond funds do not mature and their prices change daily (net-asset-value), it may difficult, if not impossible, to predict the value of an original investment at the time of sale
Costs	Either a one-time commission or an annual fee and low individual transaction charges are paid when a bond is bought and sold	Sales fees are charged; in the case of a no-load fund, annual management fees typically apply
Capital gains taxes	Paid only if a bond is sold for profit prior to maturity date	Paid if shares are sold for profit or when a fund manager sells bonds for profit (managers buy and sell bonds during the year, capital gains or losses are passed to investors) Investors may be liable for tax on imbedded gains even if they have not enjoyed the returns
Knowing what you own	Investor knows exactly what bond is bought, its credit rating, coupon rate and maturity date. 100% of the money is invested and earning interest	Investor knows the main objective of the bond fund (e.g., intermediate-term corporate bond fund), which the portfolio manager may not consistently follow, this is called "style drift." Information is available to shareholders from fund periodically detailing the bonds held in the portfolio. In addition, bond funds are not fully invested, holding cash for administrative needs and redemptions
Diversification	Several bonds are needed to achieve proper diversification. Remember: do not put all your eggs in one basket	Greater diversification is achieved with one investment because funds invest in hundreds of bonds
Liquidity	Can be liquidated at current value less a sales commission. The sales amount received may be more or less than original cost	Can be sold at net-asset-value (NAV), which may be more or less than original cost. There are no redemption charges on mutual funds sold through Raymond James

Diversification does not guarantee a profit or protect against loss.

TAKE ACTION TO MANAGE RISKS

The steps you take to manage fixed income risks in your portfolio will be dependent upon your individual circumstances, most notably what you own and why you own it. You should work closely with your financial advisor to discuss your situation and make informed decisions based on thoughtful analysis.

Reaffirm why you own fixed income and your risk tolerance

Start by confirming why you own fixed income investments and the role they play as a part of your overall asset allocation. You should also evaluate your risk tolerance in view of recent equity market volatility and the risks that may be present going forward.

> Your financial advisor can run an analysis of the specific bonds that you own and quantify the potential impact of rising interest rates on the value and total return of your bonds.

Certain risks will impact you differently depending on your objectives and the types of investments you own. As we mentioned earlier, if you own bonds to receive consistent income, you may plan to hold your individual bonds to maturity for full return of the par value. In this scenario, you may not be overly concerned about price fluctuations in the value of your bonds caused by changes in interest rates. Your priority may instead be to assure the credit quality of your investments.

With bond funds, price fluctuations in net asset value (NAV) will generally occur in response to changes in interest rates and credit quality. For example, increases in interest rates will generally reduce the NAV of bond funds.

Additionally, NAV may be affected by overall flows into or out of the bond fund. You may recall that recent record inflows into bond funds resulted in portfolio managers being forced to put cash to work in a low interest rate environment, and looking ahead, some opine that if those same inflows reverse course, portfolio managers could potentially be forced to sell bonds to meet redemptions. Additionally, bond funds have no maturity date, but are instead a collection of bonds with constant maturities because portfolio managers rarely hold underlying bonds to full maturity. Portfolio managers will cycle through bonds to maintain a certain yield, to take advantage of better opportunities, or as stated previously, to maintain cash for flows in and out of the bond fund. Unlike with individual bonds, an investor in bond funds does not have the option to hold bonds to maturity to collect par value.

It is also important to understand that there are tradeoffs with every decision you make in your portfolio. You may often find yourself trading one risk for another. For example, when considering a reduction of interest rate risk in your portfolio, you may assume larger amounts of other risks. Shorter maturity bonds of similar qualities will typically have a lower yield. Higher yielding bonds of similar maturities generally present higher credit risk. Non-dollar investments, such as foreign bonds, carry currency risk as well as geopolitical risks. Diversifying the risk components of your fixed income portfolio and matching them to your personal circumstances will be critical moving forward.

Assess possible outcomes with bonds

To get a better understanding of how certain risks might impact your investments, you can work with your advisor to forecast possible "What if?" scenarios and gauge your comfort level with different possible outcomes. Your financial advisor can run an analysis of the specific bonds that you own to assess the credit quality of your holdings, your overall exposure by credit rating and diversification across different issuers, as well as quantify the potential impact of rising interest rates on the value and total return of your individual bond holdings in terms of dollars and cents.

Together, you can determine whether your current fixed income holdings are aligned with your individual investment objectives or if changes may be prudent.

Potential strategies

While we do not recommend dramatic changes to fixed income allocations based upon day-to-day market movements, there are a number of strategies available that may help manage long-term risks.

We've presented a number of these strategies below, based on whether you'd like to maintain your fixed income exposure and manage risks within that portion of your overall allocation or prefer to reallocate a portion of your fixed income holdings elsewhere.

MANAGE RISKS WITHIN FIXED INCOME ALLOCATIONS

RISK	STRATEGY	POTENTIAL KEY BENEFITS	POSSIBLE TRADEOFFS[3]
Interest Rate Risk	**Shorten average duration** Shorten the average maturity of your bond holdings to reduce sensitivity to interest rate movements	• Lessen potential price declines if rates rise. • Allows for reinvestment of proceeds from maturing bonds into potentially higher yielding bonds at an earlier date than if longer maturity bonds are held	• Accepts lower yield
	Purchase premium or higher coupon bonds	• Higher cash flows to meet needs • Tend to be less volatile in a rising rate environment	• Greater initial investment required • A prorated portion of the amount over par can be deducted yearly on the purchaser's tax return or an investor can declare a capital loss when the bonds are redeemed at maturity or sold for a loss
	Yield curve positioning / diversification[1] Yield curve positioning may help under various interest rate scenarios. Currently, the steepness of the yield curve offers opportunities to generate "roll returns" from a strategy known as "rolling down the curve"	• May help protect principal and generate additional return in a rising interest rate environment and allow an investor to capture higher yields	• Yield curve changes may be difficult to predict • If yields rise by the full amount that the markets predict, the benefits of this strategy could be nullified
	Invest globally[2] Invest globally by seeking sovereign and corporate debt in both developed and emerging countries. May best be achieved through professional management	• Not every country will experience the same monetary policy as here in the U.S.	• Currency fluctuations • Political and credit risks in other countries
	Bank loan, floating rate bonds, high-yield and other specific bond sectors	• Some sectors of the bond market are less sensitive to interest rate risks and allow investors to accept different risks	• Higher credit risks, including greater risk of default, not appropriate for all investors • Lower current yield on floating rate instruments • Floating rate securities may decline in value if their interest rates do not rise as much as interest rates in general
Credit Risk	**Manage credit quality** Minimum "A" rating for municipal bonds. Investment grade or higher for corporate bonds and preferred securities	• Match risk and return with your needs, goals and overall risk tolerance	• All other things equal, higher rated bonds generally feature lower yields than bonds with lower ratings
	Diversify holdings among issuers Maximum of 5% concentration per issuer, state or sector	• Limit risks of a single issuer downgrade or default creating large losses for the overall portfolio	• Ongoing monitoring requirements

This strategy offers the potential to offset principal risk in a rising interest rate environment while capturing higher yields. As a bond approaches maturity it will gradually "roll down the curve" toward lower yields each year as it moves closer to maturity.

[1] Monitoring the yield curve is part of the day-to-day responsibility of fixed income managers.
[2] Investing internationally may involve currency fluctuations, political and economic risks.
[3] The purchase or sale of bonds may result in a commission or fee depending on the structure of your account.
Diversification does not guarantee a profit or protect againstloss.

MANAGE FIXED INCOME RISKS THROUGH RE-ALLOCATION			
OBJECTIVE	STRATEGY	KEY BENEFITS	POSSIBLE TRADEOFFS
Income	**Diversify Income Sources** Reallocate a portion of your fixed income holdings to other income generating securities (dividend paying stocks, etc.)	Dividends can provide a stream of income and have the potential to grow over time.	Dividends are only paid at the discretion of the board of directors and are junior in standing to bonds in the credit structure in the event of bankruptcy or liquidation. Unlike fixed income with a set term and coupon payments, equities can fluctuate in value significantly.
Total Return	**Reduce fixed income allocation in favor of other asset classes**	Directly reduce exposure to fixed income risk factors.	Requires correctly identifying attractive asset classes and accepting different risks.
Mitigate Equity Volatility	**Look to other low-correlation strategies besides bonds to mitigate equity risk** (Alternative investments, commodities, REITs)	Asset classes that have historically exhibited low correlation may play a role in mitigating the volatility of the equity markets in portfolios.	Correlations are not constant over time and strategies may not maintain their low correlation. Alternative investments may carry significant risks. *

INVEST OBJECTIVELY TOWARD YOUR GOALS, NOT REACTIVELY WITH EMOTIONS

With the anticipation of a rising interest rate environment and concerns over credit quality, including that of many municipalities, investors have good reason to assess bonds going forward. In view of where we are in the interest rate cycle and the broader economic recovery, now is an opportune time to evaluate your fixed income investments and determine if action is warranted.

WORK WITH YOUR FINANCIAL ADVISOR

While drastic changes may not be necessary in your portfolio, it is important for you to work closely with your advisor, evaluate your circumstances and take action when appropriate. Your financial advisor possesses the tools, resources and expertise to help you:

- Reaffirm why you own fixed income and the role it plays in your overall portfolio and financial plan ▶
- Reevaluate your risk tolerance and understand the risks currently facing fixed income investors ▶
- Understand the products you own and the risk profile associated with each ▶
- Forecast potential scenarios and the impact on your portfolio ▶
- Identify and implement appropriate strategies to manage risks

* Asset allocation and diversification do not ensure a profit or protect against a loss. Investment suitability must be determined for each individual investor. Investing involves risk and investors may incur a profit or loss.

This information herein was obtained from sources which we believe reliable, but the accuracy of which cannot be guaranteed. No representation is made that it is accurate or complete, that any returns indicated will be achieved, or that you should rely on it to make an investment decision. Changes to assumptions may materially impact returns. Past performance is not indicative of future results.

Alternative investments involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements, including minimum net worth tests. You should consider the special risks with alternative investments including limited liquidity, tax considerations, incentive fee structures, potentially speculative investment strategies, and different regulatory and reporting requirements. You should only invest in hedge funds, managed futures or other similar strategies if you do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

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880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863

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