



Market Review

In the first quarter of 2012, the U.S. economy showed signs of improvement. Most of the economic data, including jobs growth and GDP growth, pointed towards strength in the economy. The concerns about European sovereign debt were subdued as sovereign nations made better progress in taking steps to prevent recession in their economies. As a result, U.S. Treasuries posted their worst performance since the fourth quarter of 2010, while risk-on trades gained traction. The spreads on corporate bonds, generally, and high-yield bonds, specifically, declined as investors regained their confidence and chased yields in riskier assets resulting in positive returns for most of the non-Treasury sectors. At its March 13, 2012 meeting, the Federal Reserve sounded positive as it indicated that "...the unemployment rate has declined notably in the recent months...household spending and business fixed investment have continued to advance...". However, the Federal Reserve indicated some concern about short-term inflation and admitted that "...the recent increase in oil and gasoline prices will push up inflation temporarily...". Nonetheless, the Federal Reserve remains committed to their highly accommodative stance for monetary policy. In the first quarter of 2012, the Treasury yield curve steepened as the spread between the 2 year Treasury and the 10 year Treasury increased 24 basis points from 164 basis points as of December 31, 2011 to 188 basis points as of March 31, 2012. Similarly, the spread between the 2 year Treasury and the 30 year Treasury increased 36 basis points from 265 basis points as of December 31, 2011 to 301 basis points as of March 31, 2012.

Fixed income returns for the first quarter ranged from -7.71% for the 30 year U.S. Treasury Index to 6.28% for the Long Financial Index. The broadly followed Barclays Capital U.S. Aggregate Index had a total return of 0.30%. Its yield decreased slightly by 2 basis points from 2.24% on December 31, 2011 to 2.22% on March 31, 2012. The 6-month T-Bill Index had a total return of 0.01% and the 2-year Treasury Index had a total return of -0.08%, whereas the 10 year Index had a total return of -2.25%, and the 30 year Index had a return of -7.71%. From December 31, 2011 to March 31, 2012, the yield of the

2 year Treasury Index increased by 9 basis points from 0.25% to 0.34%, the yield on the 10 year Treasury Index increased by 35 basis points from 1.87% to 2.22% and the yield on the 30 Year Treasury Index increased by 46 basis points from 2.89% to 3.35%. Triple-B credits out-performed triple-A credits in the first quarter with a return of 2.42% versus 0.66%, for a difference of 176 basis points. Both the single-A and double-A credit sectors also under-performed the triple-B sector with first quarter returns of 2.23% and 1.47%, respectively. Among corporate bonds, the financial sector had the best return at 5.07%, with longer dated financials posting a return of 6.28% and intermediate financials posting a return of 4.83%. Both the industrial and utility sectors under-performed the financial sector with returns of 0.76% and -0.07%, respectively. The long industrial and long utility sectors posted first quarter returns of -1.00% and -1.77%, respectively. Intermediate industrial and intermediate utility sectors had returns of 1.54% and 1.14%, respectively.

Residential mortgage-backed securities ("MBS") produced a first quarter return of 0.57%. The duration of the MBS sector increased from 2.87 years as of December 31, 2011 to 3.32 years as of March 31, 2012 and there was an increase in the duration of the Aggregate Index from 4.95 years at December 31, 2011 to 5.01 years at March 31, 2012. In the first quarter, the tax-exempt municipal bond market experienced strong positive returns across the yield curve with longer maturity municipals posting the best performance. Total returns for the first quarter ranged from 0.33%, posted by 1 year municipals, to 3.80% for the 22+ year Municipal Index. Among municipal credits, the 4.17% return for the Baa Index was higher than the 0.74% return for the AAA Index. Tax-exempt municipals significantly outperformed US Treasuries across the yield curve. The 0.59% return for the 10 Year Municipal index was 284 basis points higher than the -2.25% return for 10 Year Treasuries. The 5 Year Municipal Index had a total return of 0.58%, which was 106 basis points higher than -0.48% for 5 Year Treasuries. There are no tax-exempt municipal bonds in the Aggregate Index.



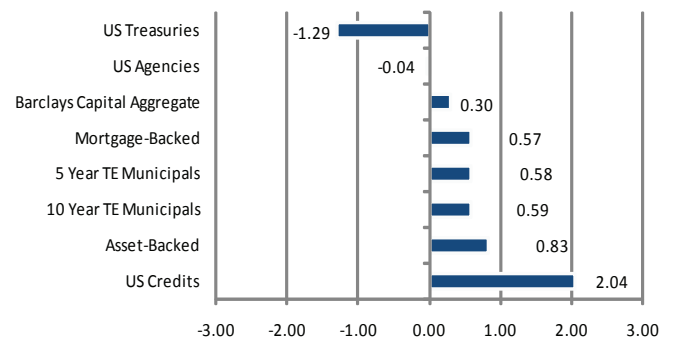
Market Outlook & Strategy:

In the near term, expectations of continued volatility in financial markets imply an abnormal level of interest rate uncertainty. Longer term, a self-sustaining economic recovery and increase in U.S. Treasury issuance should put upward pressure on the general level of interest rates. Currently, we are maintaining a neutral duration strategy versus our respective benchmarks and are positioning the yield curve distribution closer to that of the benchmark. In the first quarter, we modestly increased our allocation to the financial sector due to valuations and relative value opportunities. Taxable municipals (included in Non-Corporates) continue to be well represented in our portfolios. We decreased our allocation to tax-exempt municipals and will continue to closely monitor the yield relationship between Treasuries and tax-exempts municipals (“muni ratio”) to identify relative value opportunities.

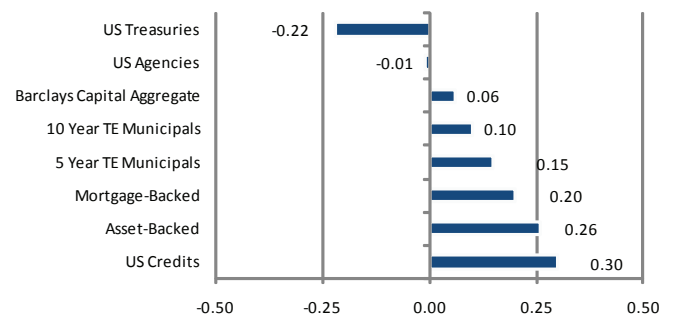
Fixed Income Team

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Shalini Sharma, CFA, CPA	15 Years
Timothy Heaney, CFA	22 Years
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First Quarter Fixed Income Sector Returns



First Quarter Fixed Income Return per Unit of Duration



Source: Barclays Capital

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