

NATIONAL COUNCIL ON
TEACHER RETIREMENT



Opportunities in the Fixed Income Markets
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Kevin Kearns
Vice President, Portfolio Manager
Loomis, Sayles & Company, L.P.

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Overview

- Current opportunities and risks in fixed income
- Fixed income instruments and strategies
- The credit cycle: where are we now?
- Current market review
- Future opportunities given various economic scenarios

Big Picture

Where are we? What should we worry about?

Deflationary Environment

- Emphasize high quality
- Debt likely to outperform equity
- Capital-intensive and lower quality companies will likely struggle
- Japan's "Lost Decade" scenario
- Further potential USD weakness

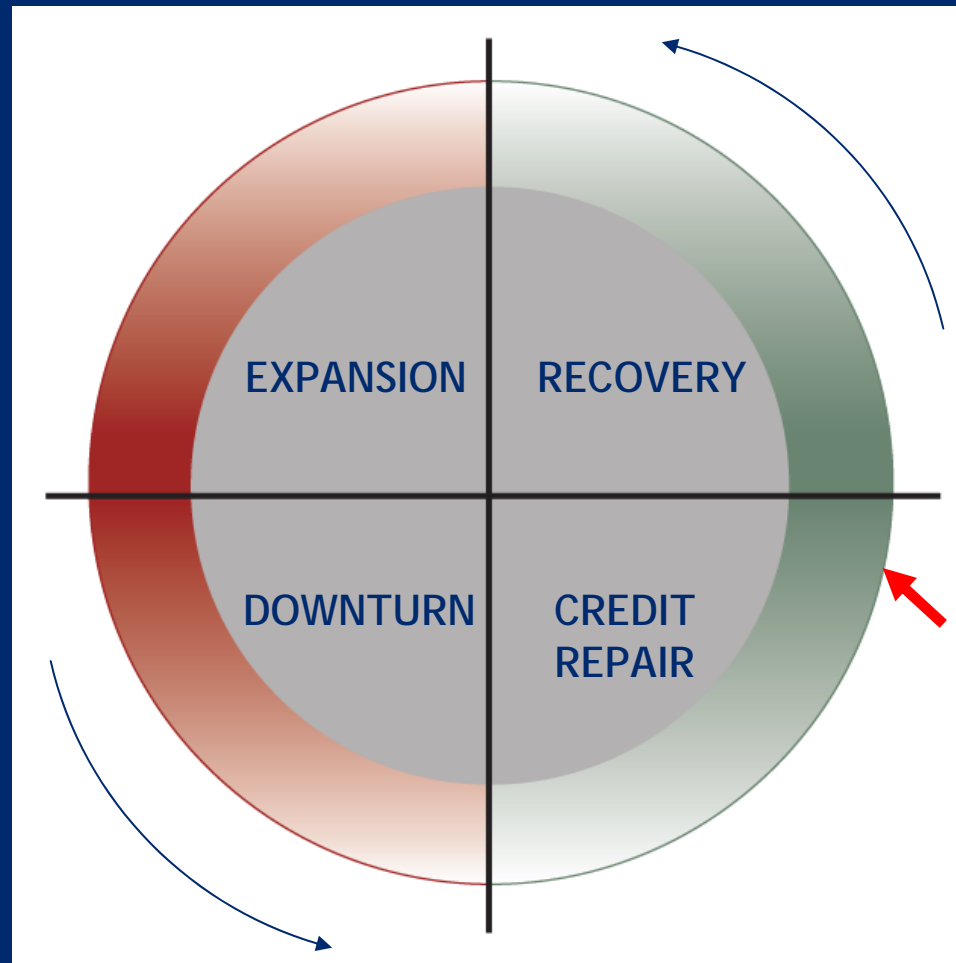
Inflationary Environment

- Equity and high yield will likely outperform
- US Treasuries and government agencies will likely underperform
- TIPS are only part of the answer

The Credit Cycle: Where are we now?

- Equity outperforms credit
- Emphasis on late cycle boomer industries (basic industries, capital goods)

- Equity & credit negative
- Emphasis on defensive industries (consumer staples, utilities)



- Equity & credit positive
- Emphasis on cyclical industries (basic materials)

- Credit outperforms equity
- Emphasis is cycle-specific (financials, technology)

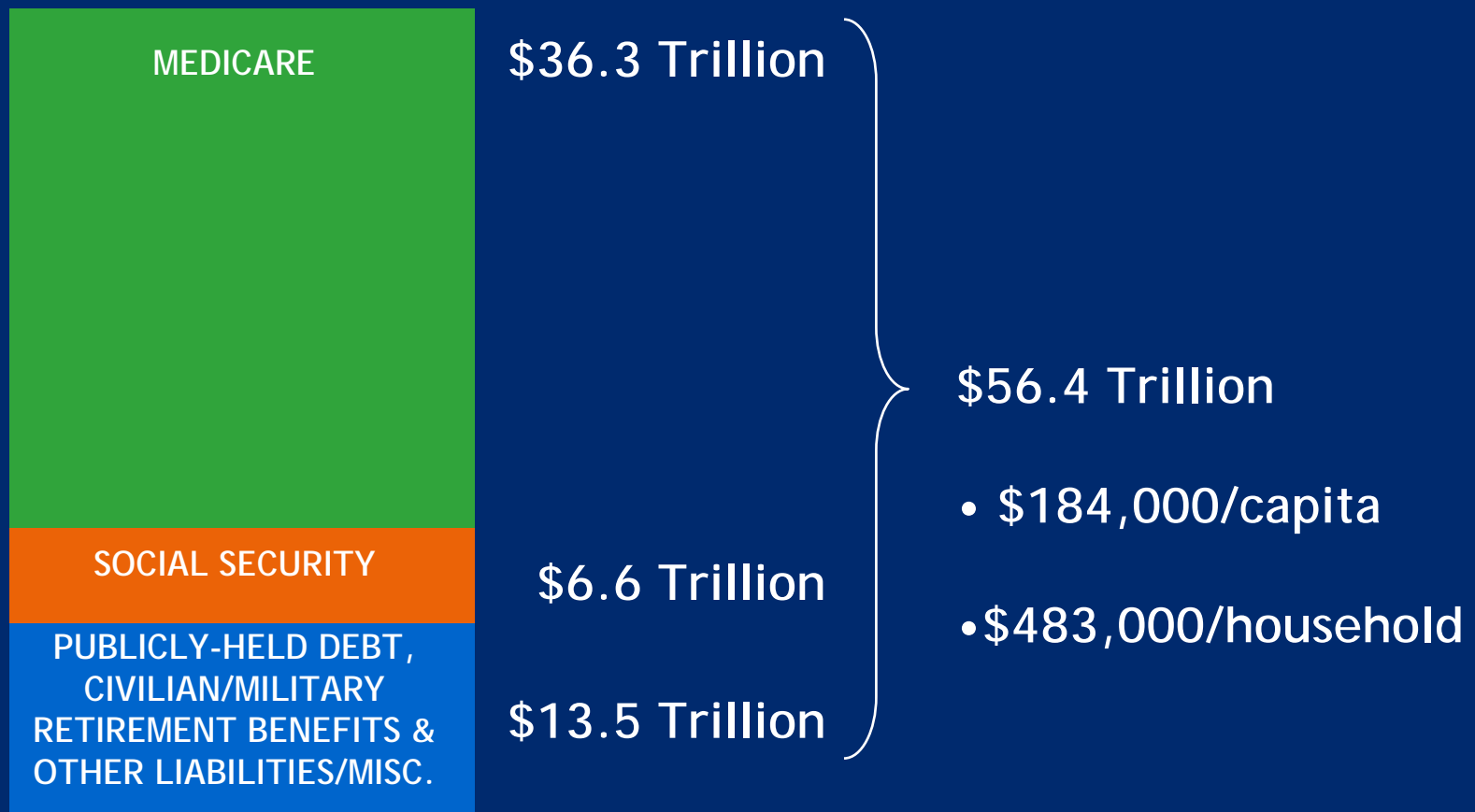
The Fixed Income Opportunity Set

Common Instruments & Strategies

GEOGRAPHY	ASSET CLASSES	STRATEGIES	INSTRUMENTS/ SECURITIES
Global	Investment grade	Directional (Long or short)	Cash bonds
	High yield	Curve	Credit derivatives
	Convertible/ hybrid	Pair	Interest rate futures/derivatives
	Government	Volatility	Non-US dollar derivatives
	Structured	Capital structure arbitrage	Structured securities
	Distressed	Quantitative strategies	Bank loans
	Non-US dollar	Correlation	Equity/equity options

Common Question

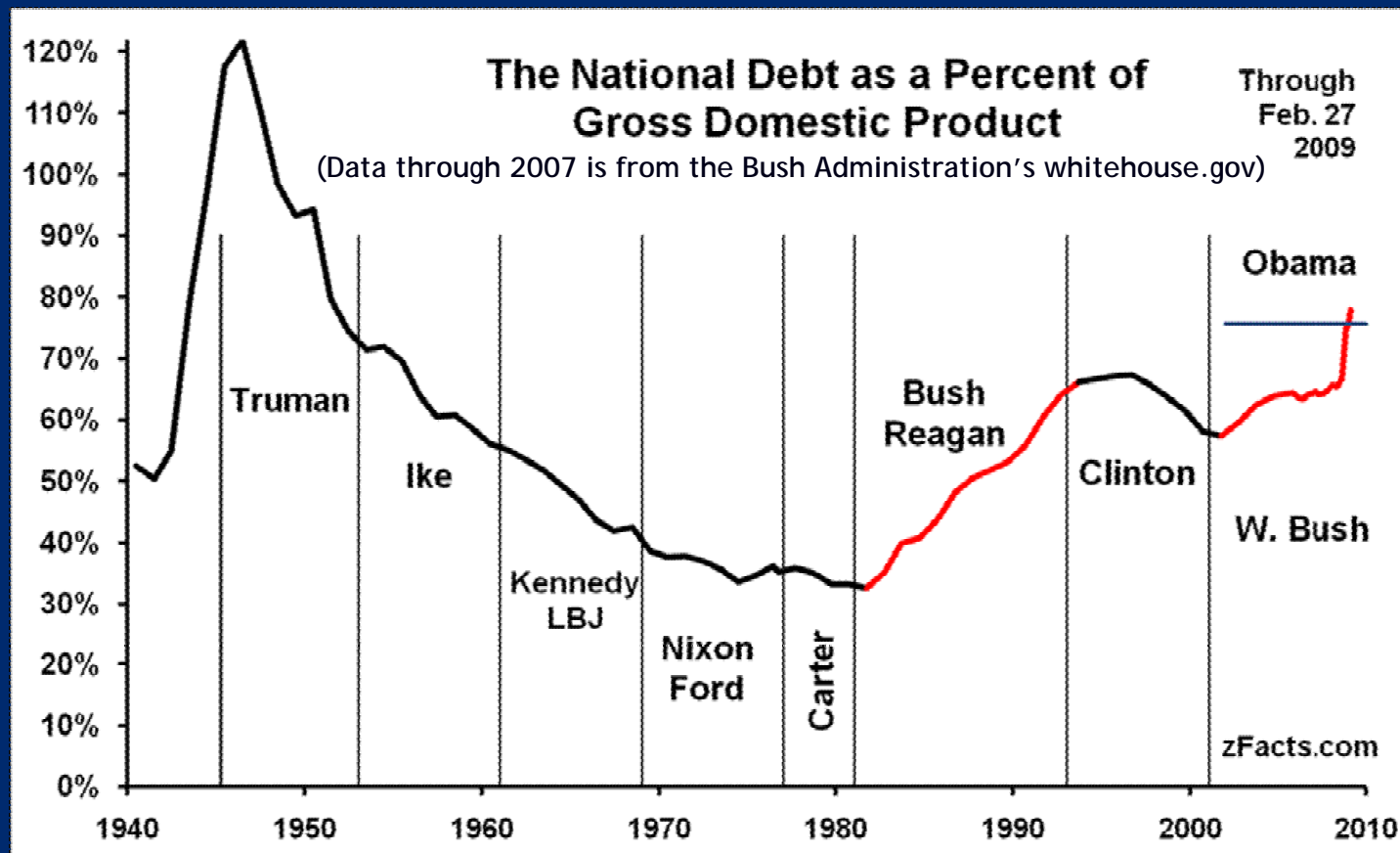
How is this cycle different from past credit cycles?



Source: 2008 Financial report of the US government, US Department of the Treasury. The Medicare and Social Security figures represent the unfunded promises of these programs as of 1/1/08. Per capita and household burden calculated using March and December 2008 estimates from the US Census Bureau. Other data as of 9/30/08.

Common Question

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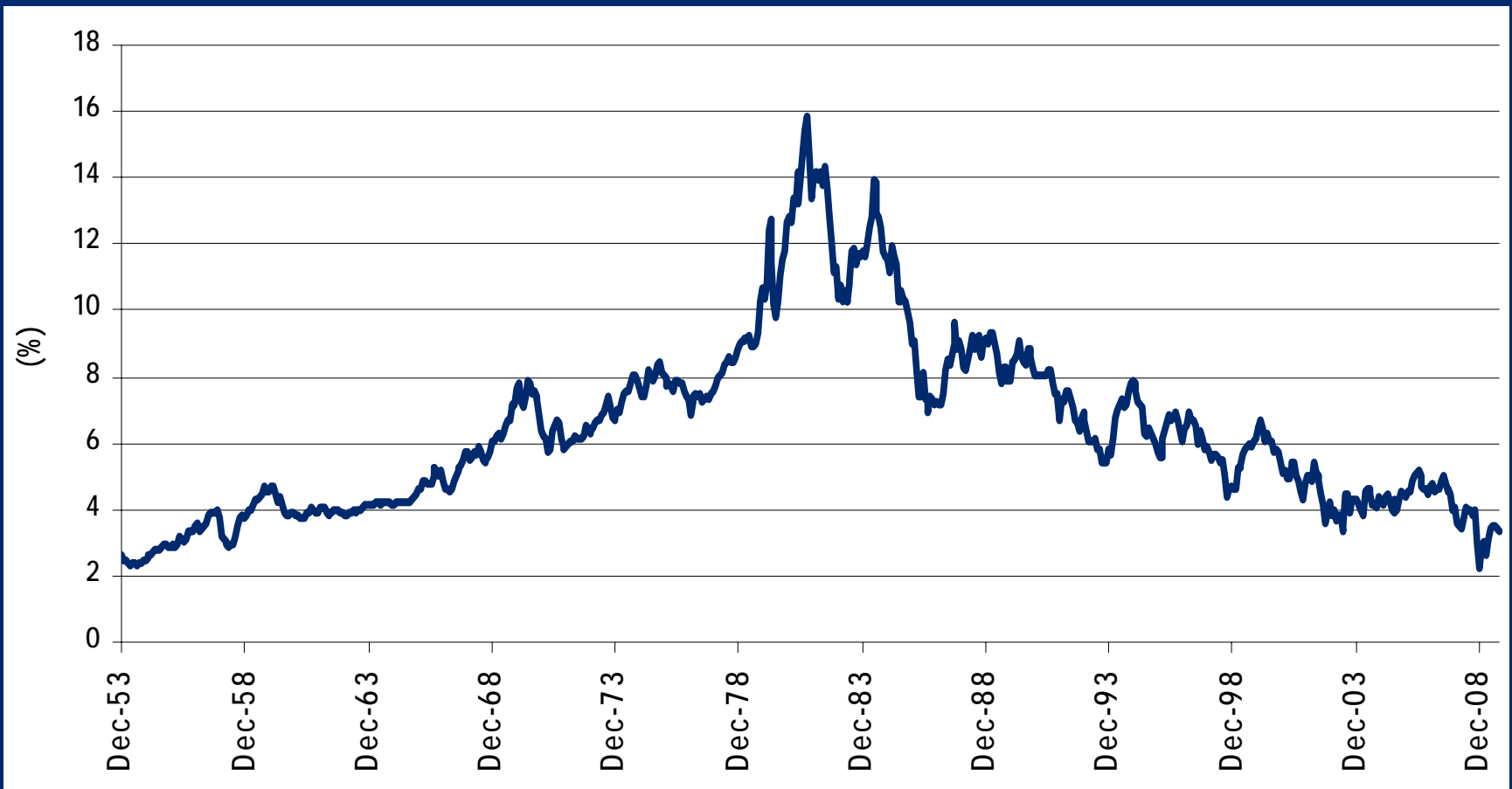


Source: zFacts.com. Black line denotes reduction in National Debt as a percent of GDP, red regions denote increase. Blue line indicates beginning of Obama Administration.

Market Review

10-year US Treasury Yields

12/31/53 - 9/30/09

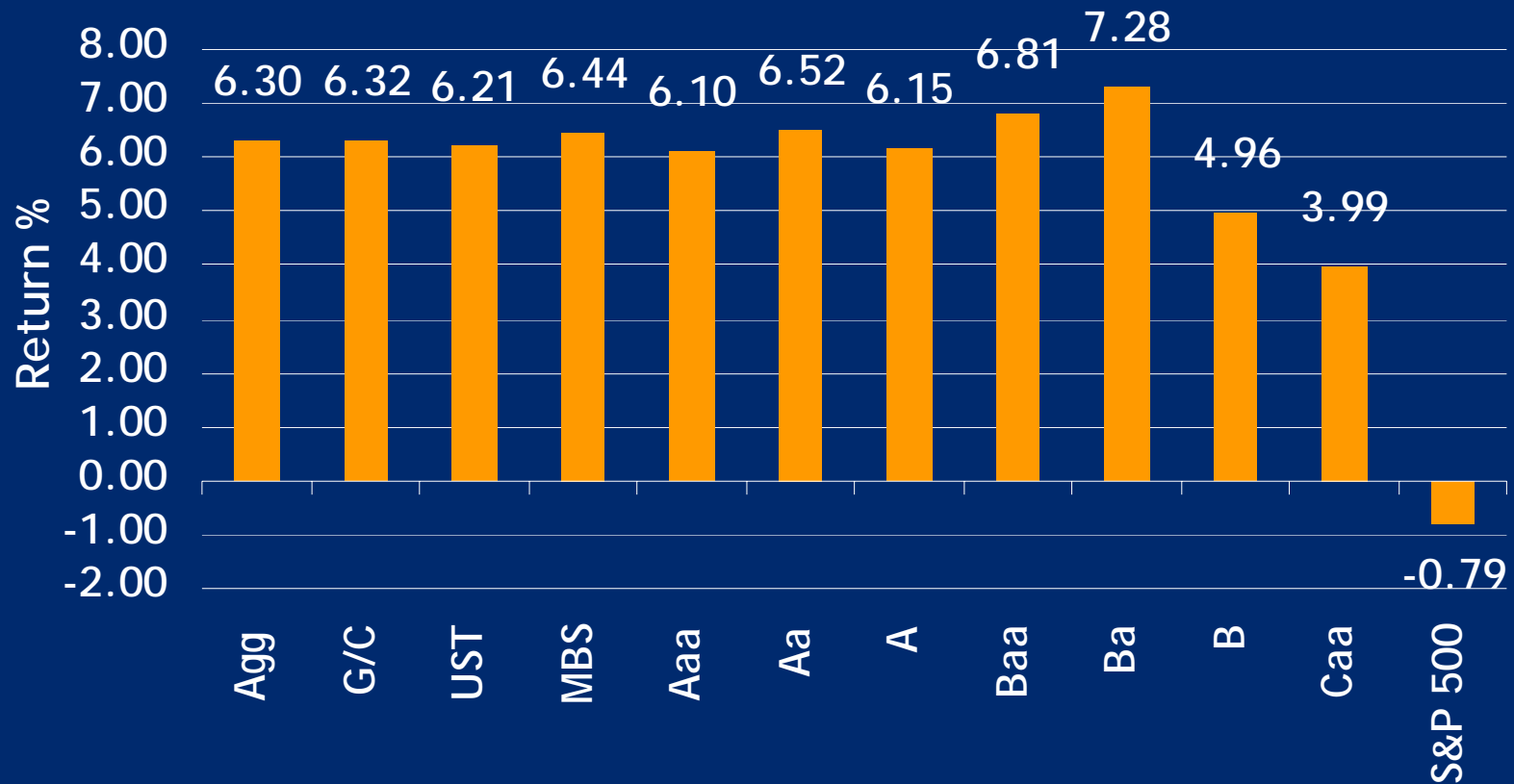


Source: Bloomberg

Market Review

US Market Returns By Quality

Ten Year Annualized Returns as of 9/30/09



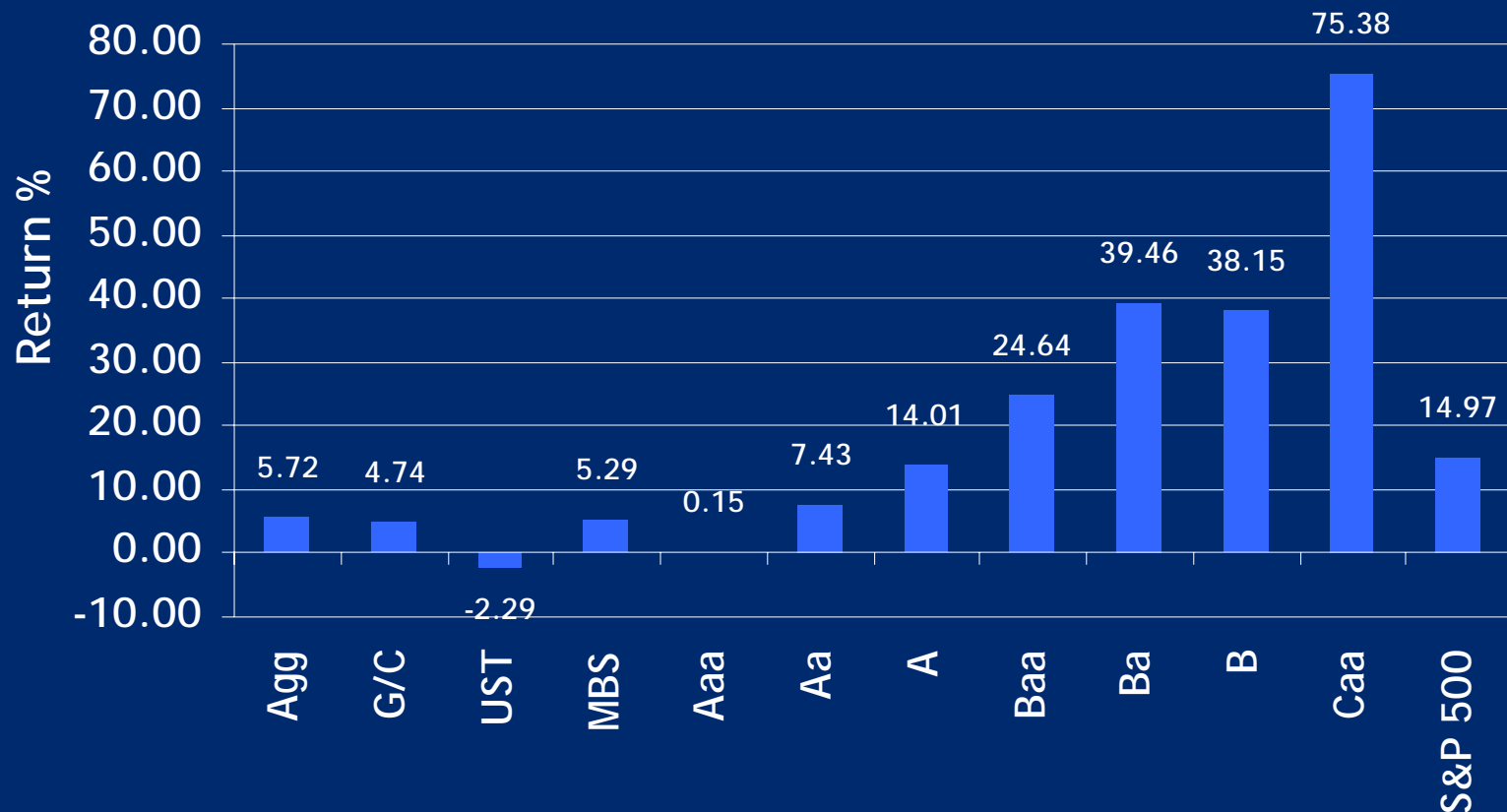
Source: Barclays Capital

Agg. stands for Barclays Capital Aggregate Bond Index. G/C stands for Barclays Capital Government/Credit Bond Index

Market Review

US Market Returns By Quality

Year-to-date (YTD) Returns through 9/30/09

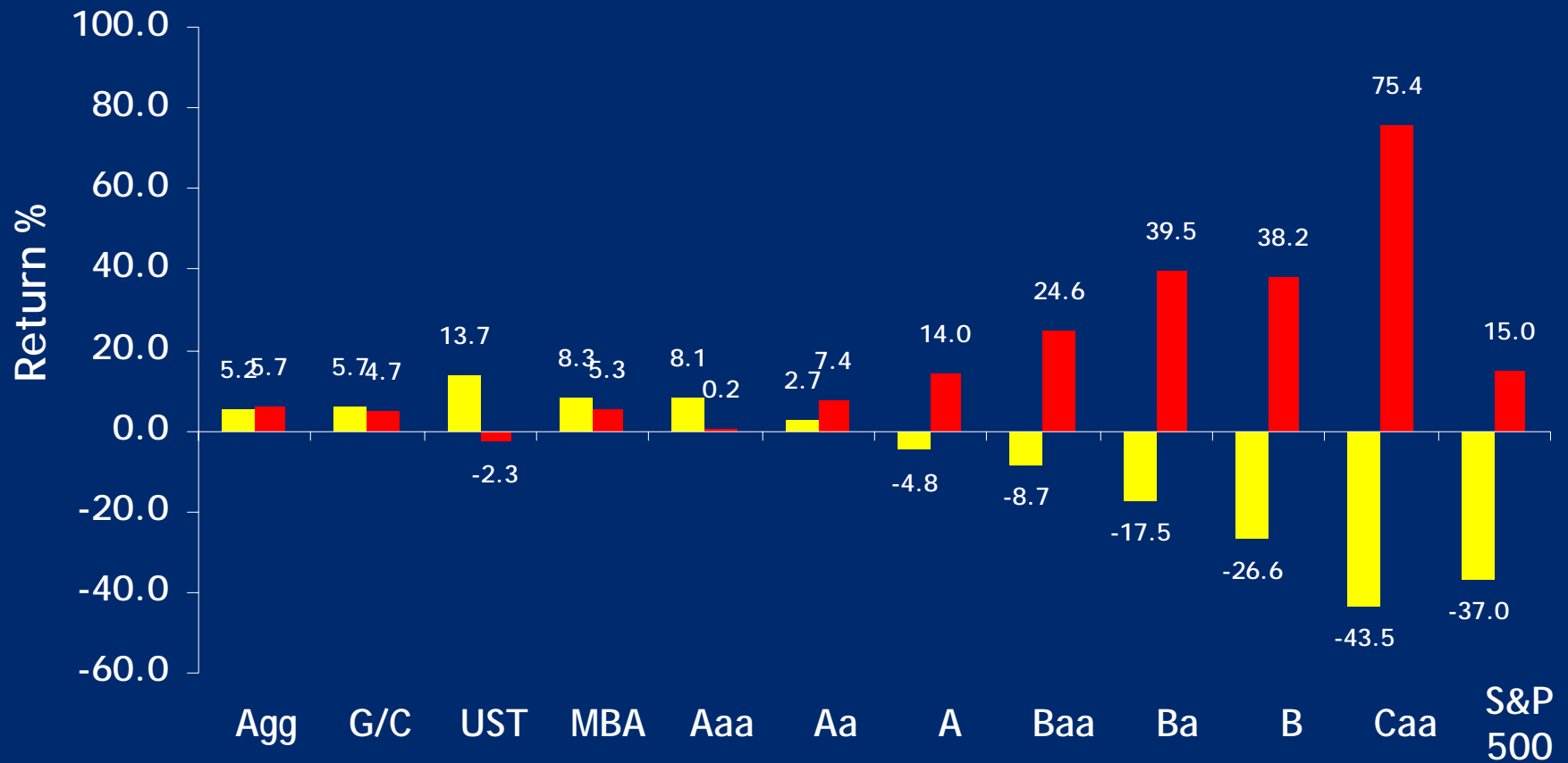


Source: Barclays Capital, returns shown are cumulative

Market Review

US Market Returns By Quality

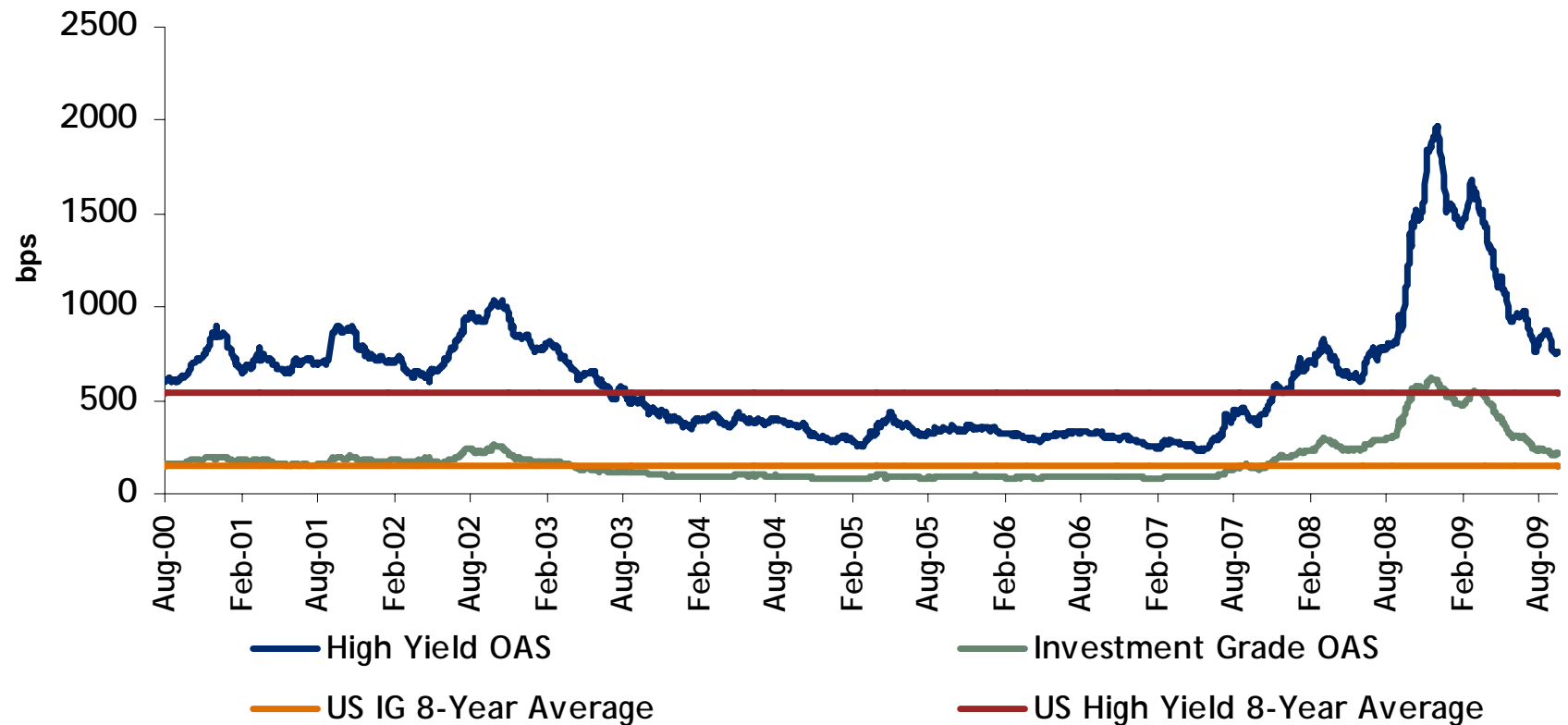
YTD 9/30/09 vs. Calendar 2008



Source: Barclays Capital, returns shown are cumulative

Market Review

US Investment Grade & High Yield Option-Adjusted Spreads

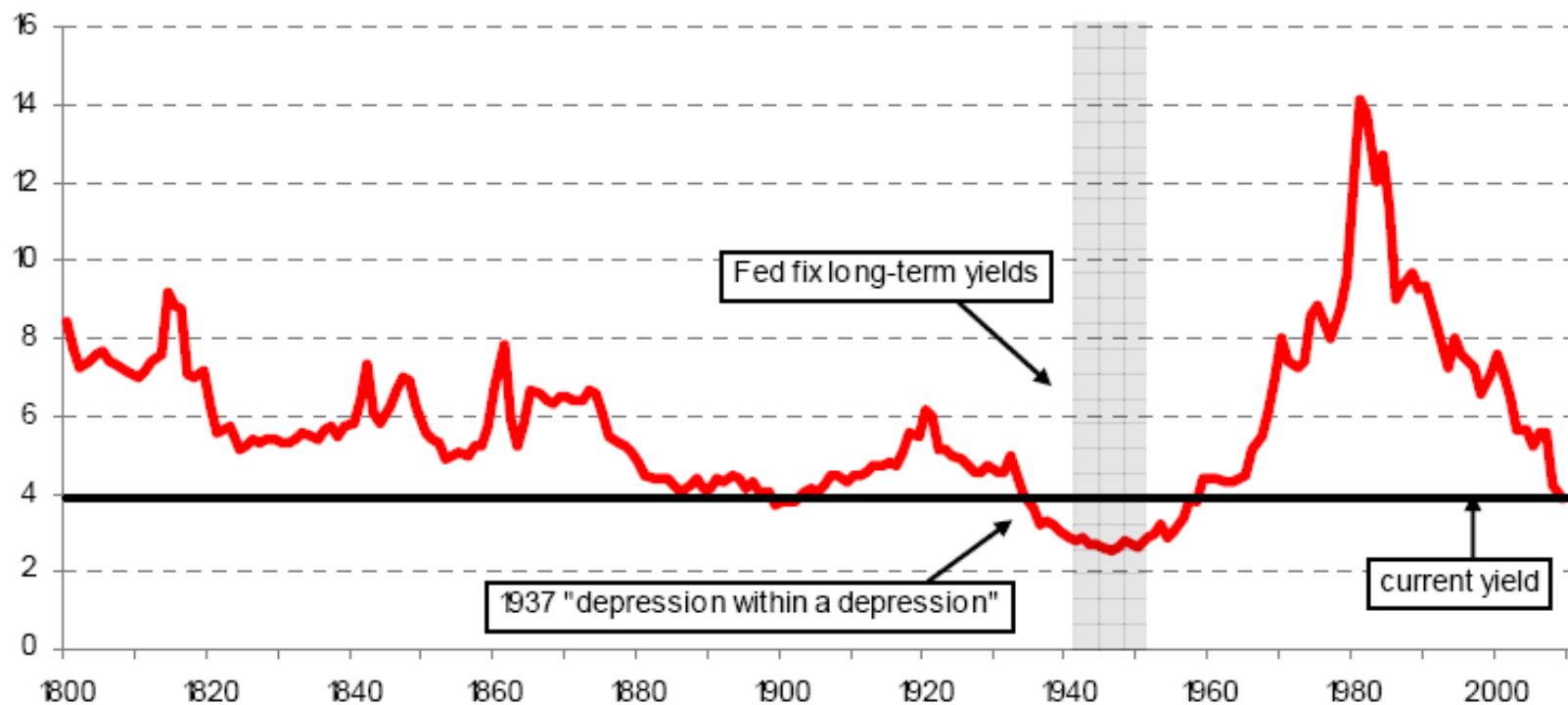


Source: Barclays Capital, history through 9/30/09

Market Review

Is The US Treasury Market Really Risk Free?

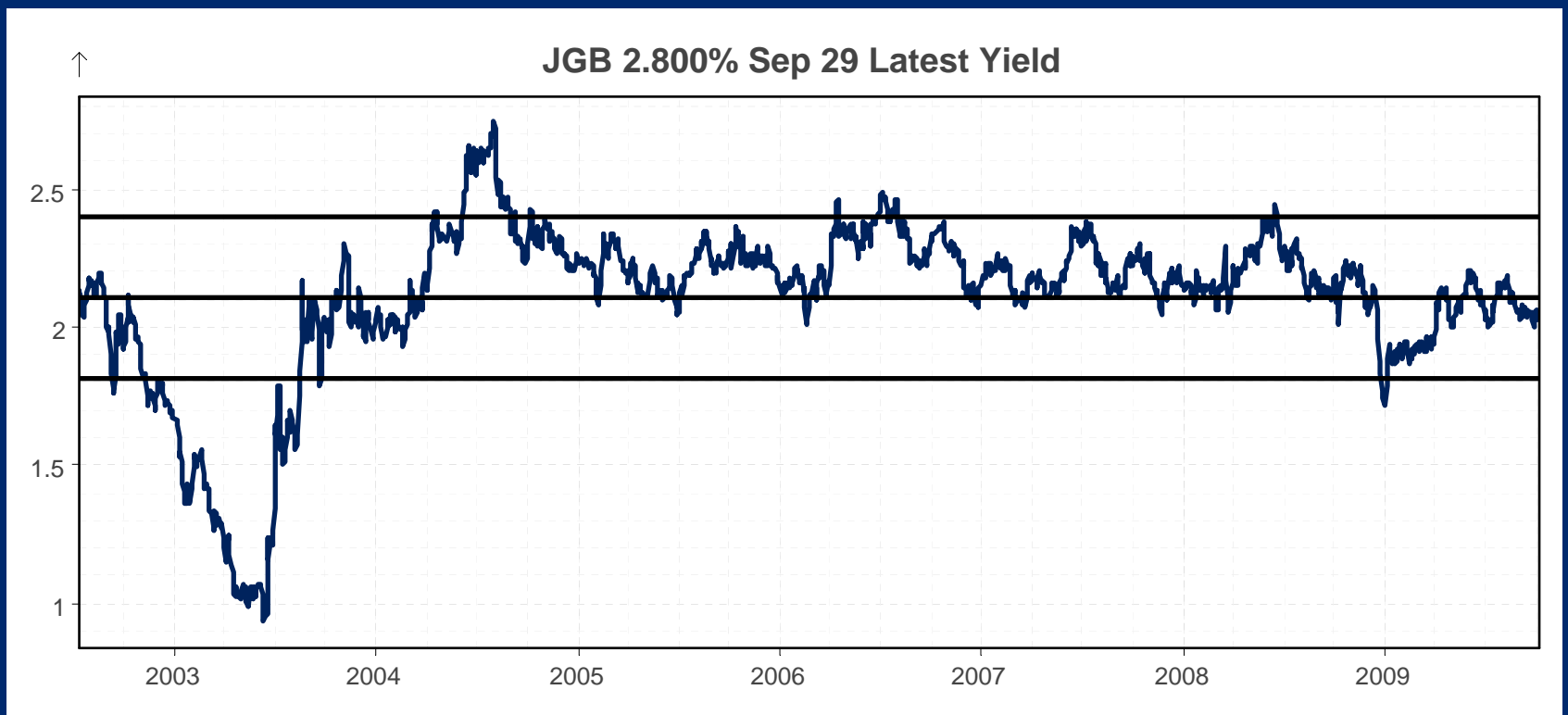
Treasury yields have only been lower during the Depression, or when prices were fixed



Source: Homer & Sylia, SG Global Strategy

A Look at Japan

It could remain this way indefinitely



Source: *LehmanLive*

So where do we think there is opportunity?

- Fixed income portfolio with broad flexibility & diversification
 - Global, including emerging market debt
 - Conservative high yield, crossover and selected securitized products
 - Long/short credit and currency portfolios
 - Broaden mandates to capitalize on potential currency and rate volatility
 - A US Treasury-only portfolio would not sufficiently compensate investors
- We do not expect volatility to go away—dollar, deficit, federal stimulus withdrawal, geopolitical and economic trends indicate that the next decade won't be slow & boring.

Disclosure

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Indexes are unmanaged and do not incur fees. You cannot invest directly in an index.

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