Fixed Income Commentary

September 30, 2014 ~ Elizabeth D. Swartz, *Senior Vice President - Manager of Investment Services*

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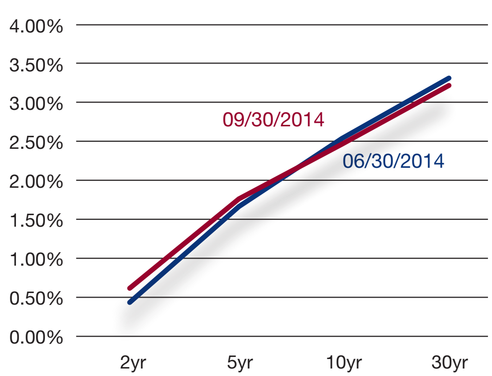
Fixed Income Market Comments

U.S. economic data continued to be solid over the latest quarter and inflation expectations remain low. If the domestic economy remains on track, the Federal Reserve's bond purchasing program will come to an end in October. That does not mean that they will be taking any action in terms of monetary policy; the end of tapering doesn't mean the beginning of tightening. While the latest unemployment report dipped below 6%, the debate remains over the labor participation rate and its influence on the number. The number of people in the work force has been decreasing over the past 10 years and is expected to continue to move lower due to an aging population. What slack remains in the labor market is working through at a good pace. The Fed has been focusing on wage growth and although wages have risen approximately 2% year over year, this does not appear to be enough to force a move in the current policy. Businesses have also recently reported intentions to increase hiring and wages in 2015. Consumer spending has been limping along. Due to the employment data improving, contained energy prices and overall net worth trending higher, the consumer could be in a position to push this recovery forward. The second quarter's uptick in some of the inflation data had a lot of "noise" associated and the more recent underlying trend remains below the FOMC's target. In light of the current economic environment, it appears the Fed remains on track to make adjustments to short term interest rates towards the middle of 2015. In spite of all the Fed posturing, interest rates continued to trade in a narrow range and returns are flat to slightly negative for the third quarter, but still positive year to date. The yield curve continues to flatten, signaling more moderate growth and overall contained prices. A fixed income portfolio provides a consistent stream of income, principal protection and a reduction in the overall volatility of a balanced portfolio. In spite of which direction interest rates move, we believe fixed income exposure is a necessary part of overall asset allocation and individual objectives will determine how much should be allocated to this asset class.

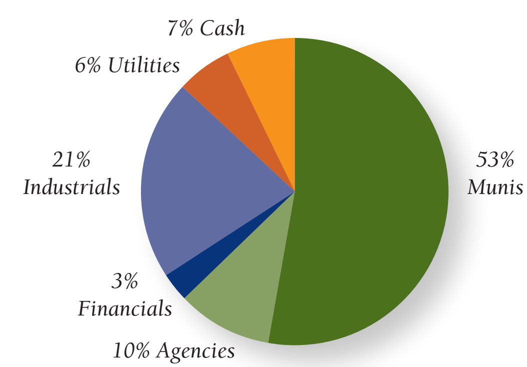
Taxable Fixed Income Performance Composite

The TCVA taxable, fixed income composite outperformed its benchmark for the quarter ending September 30, 2014. The composite has maintained an average weighted maturity and duration shorter than the benchmark. Characteristics of the composite included a large exposure to investment grade, corporate and taxable municipal bonds and higher overall credit quality. There has been an increase in exposure to corporate debt over the past quarter due to relative attractiveness of the sector. Maintaining above average income levels continues to be a challenge without compromising on the quality of the securities. The yield curve continues to flatten, making a barbell approach to the management of assets more appealing. However, building and monitoring a fixed income portfolio with weighted average durations shorter than the respective benchmarks remains the best defensive strategy in the current rate environment.

Treasury Yield Curve



Fixed Income Sector Breakdown



Portfolio Characteristics:	
Average Maturity	2.9 yrs
Average Duration	2.7 yrs
Average Yield to Maturity	2.5%
Average Coupon	4.48%
Average Quality	AA

Credit Quality:	
AAA	20%
AA	47%
A	22%
BBB	11%