

Seix Investment Advisors Perspective

ABOUT THE BOUTIQUE: Seix Investment Advisors LLC



Seix Investment Advisors LLC (Seix) is a fundamental, credit-driven fixed-income boutique specializing in both investment grade and high yield bond management. Seix has employed its bottom-up, research-oriented approach to fixed income management for over 15 years. The firm's success can be attributed to a deep and talented group of veteran investment professionals, a clearly defined investment approach and a performance-oriented culture that is focused on delivering superior, risk-adjusted investment performance for our clients.

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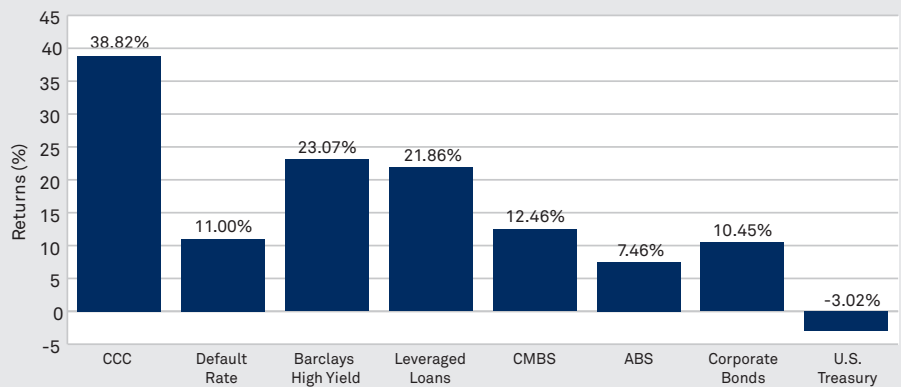
Jim is Chief Investment Officer and leads the High Grade division of Seix. Prior to joining the firm in 2008, Jim was Head of Investment Grade Corporate & High

Yield Bond Management for American Century Investments, Chief Investment Officer at Westmoreland Capital Management and Managing Director of High Grade and High Yield Fixed Income at UBS Global Asset Management. Jim's High Grade team sub-advises several of the RidgeWorth Funds, including the RidgeWorth Investment Grade Bond Fund which won a Lipper Performance Award in 2009. He has appeared on CNBC and Bloomberg television, and has been quoted in a range of national publications. Jim received a B.S. degree from St. Francis College and an M.B.A. degree from Fordham University. Jim has more than 25 years of investment management experience.

REVIEW OF SECOND QUARTER 2009

"The Great Recession" took a back seat to the "reflation trade" in the second quarter with all spread sectors outperforming U.S. Treasuries as markets reversed the "flight-to-quality" strategy thereby putting upward pressure on interest rates and leading to a lower dollar. Risky assets led the way during the second quarter and investors with the highest risk appetites benefited the most as the lowest quality, weakest credits (38.82%) in the high yield market outperformed all other fixed income sectors and bested equities. Defaults accelerated throughout the quarter with such high profile defaults as General Motors, Chrysler, RH Donnelley, Abitibi-Bowater and Extended Stay. The default rate rose to 11% and will surpass the all time peak of 12.07% reached in 1991. Nevertheless the high yield market enjoyed its best quarter (23.07%) and 6-month period (30.43%) in the history of the Barclays (formerly Lehman) High Yield Index. Leveraged loans performed exceptionally well with returns of 21.86% (best quarter) and 34.63%, respectively in the quarter and year-to-date periods. Returns for the other spread sectors were also impressive in the second quarter, as CMBS (12.46%) and ABS (7.46%) posted their best quarters ever and corporate bonds (10.45%) had their best quarter since the early 80s. The U.S. Treasury index generated a negative return of 3.02%. (see Exhibit 1)

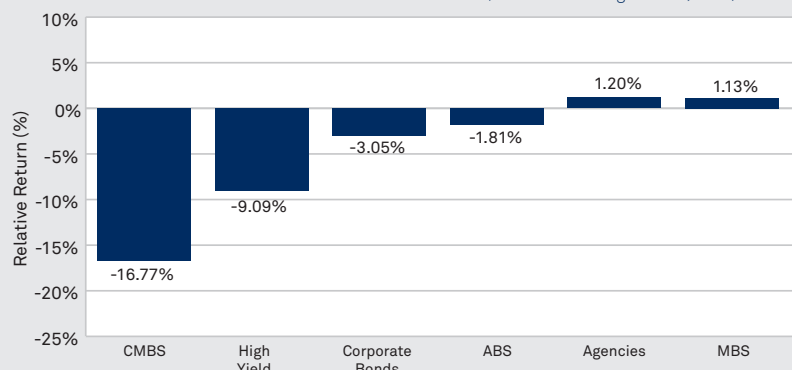
Exhibit 1: Second Quarter Returns for Bond Sector



Source: Barclays Capital

To put this historic last year in its proper perspective it should be noted that despite this massive spread sector rally, U.S. Treasuries have outperformed by a wide margin. In fact, in the last 12 months most spread sectors actually underperformed Treasuries by significant margins: CMBS (-16.77%); high yield (-9.09%); corporate bonds (-3.05%); ABS (-1.81%). Only Agencies (+1.20%) and MBS (+1.13%) outperformed Treasuries compliments of over \$700 billion in direct asset purchases by the Fed. (see Exhibit 2)

Exhibit 2: Returns Relative to Treasuries (12 months ending June 30, 2009)



Source: Barclays Capital

Interest rates were volatile to say the least as the 10-year U.S. Treasury started the quarter at 2.66% rose to 3.95% in mid June only to end the quarter at 3.54%. Market sentiment had shifted from deflation to reflation with some concern that the Federal Reserve's zero interest rate policy/quantitative/credit easing will end in an inflationary spiral. Make no mistake about it, we are in uncharted waters and there are no valid historical comparisons to where we are now.

The "green shoots" (PR) campaign that began with the unprecedented "60 Minutes" interview of Chairman Bernanke is rightfully being called into question as unemployment, housing and consumer wealth continue to deteriorate. The policy responses appear to be designed to put humpty-dumpty (the shadow banking system) back together again. The strategy employed by policymakers seems focused on propping up asset prices (stock prices in particular) and changing psychology. The thinking goes something like this — if the negative feedback loops can be changed to positive feedback loops, stock prices will rise and "animal spirits" will re-emerge leading consumers to revert back to the profligate debt-financed consumption binge that got us into this predicament in the first place. This strategy is not likely to be successful for the following reasons: consumer concerns are dominated by job security issues with the unemployment rate at 9.5% (26-year high) and going higher and the underemployment rate at 16.5% (all-time high); and consumers realizing that they must repair their balance sheets by living within their means and saving the old fashioned way.

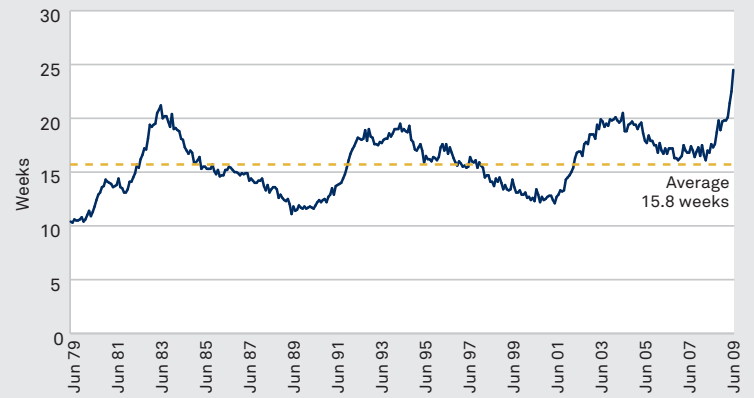
Employment, which has historically been seen as a lagging indicator, is likely to be a leading indicator this cycle as we transition away from a financial services/ real estate dominated economy with the job security issue remaining front and center in terms of consumer psychology. There is a structural rather than cyclical element to these job losses as many of these jobs that have been lost, particularly in FIRE (finance, insurance and real estate), are not coming back and these displaced workers will have to find careers in other industries that in all likelihood will not pay as well. It is taking longer for people to find new jobs as indicated in the most recent employment report as the average duration of unemployment jumped to 24.5 weeks versus an average of 15.8 weeks over the last 30 years. (see Exhibit 3) According to government statistics there are six people applying for every job opening as compared to a year ago when there were two applicants for each job opening. As the supply of labor expands it puts downward pressure on wages. Lower wages combined with fewer hours worked (the average workweek fell to a record low of 33.0 hours from 33.8 hours in the second quarter of 2008) results in less income and consumer spending power. (see Exhibit 4)

Job losses are largely responsible for the increase in problem mortgage loans that have now infected the prime, as opposed to sub prime, borrowers. Fixed rate prime delinquencies have jumped to 4.68% from 2.56% at year end 2007, while foreclosures have almost tripled to 1.46% from 0.55%. This will put additional supply into the already depressed housing market putting further downward pressure on home prices, which have already declined 32.6% from the peak in July 2006 according to the Case Shiller data.

The inflation versus deflation debate is getting lively almost two years after the popping of the greatest credit bubble in modern times. The inflation camp focuses on the Fed's quantitative easing/ money printing/ excess reserves. The deflation camp is focused on the deleveraging process in the financial and consumer sectors, in addition to massive excess global capacity.

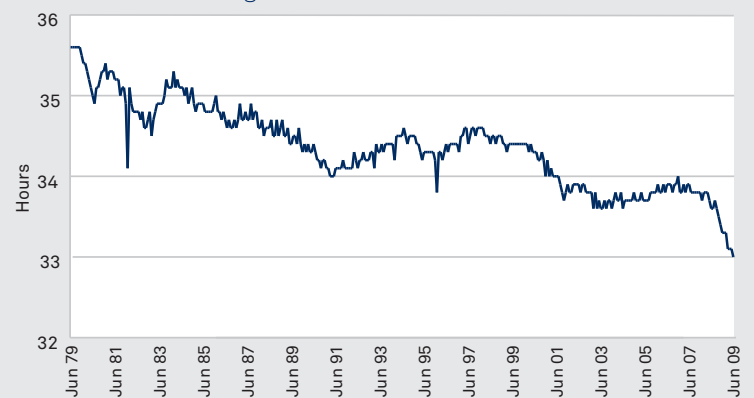
The deleveraging process within the financial and consumer sectors will be measured in years not quarters and will continue to exert deflationary pressures on asset prices. (Deflation remains the more immediate risk in our view.) Many financial companies leveraged themselves 35-40:1 and will not be able to grow their way out of this problem. For many of these institutions the only solution for real deleveraging is debt for equity restructurings. But policymakers in the Obama administration, like the Bush administration, have largely ignored the excessive debt (too much debt supported by too little real income) problem that we have in the U.S.

Exhibit 3: Average Duration of Unemployment



Source: Bureau of Labor Statistics

Exhibit 4: Average Workweek



Source: Bureau of Labor Statistics

Debt can directly be reduced by being paid off, restructured or by being defaulted on. However, there is a more insidious way to penalize savers and reward debtors with excessive debt and that is through inflation. Inflation reduces the real value of nominal liabilities. Would the Federal Reserve resort to inflating away the excessive debt problem in this U.S.? Record budget deficits make inflation more tempting as a quick fix. There are concerns that the Fed has lost its independence and will monetize the debt through its quantitative easing/ money printing. The Federal Reserve Chairman must demonstrate that the Fed is independent and not an arm of the Treasury or the administration. A starting point for such a declaration would be for the Fed to vociferously and actively campaign against massive government spending and record budget deficits that need to be financed during the first synchronized global contraction where many countries are engaged in massive fiscal spending programs.

Washington, D.C. is now the financial capital of the world as the government is directly involved in the private sector in such industries as financial services, autos, energy and health care and through the appointment of a “compensation czar.” Industrial policy and interfering in the private sector are real concerns to the economy and the capital markets. What are the rules in this “new corporate order”? What are unintended consequences? I believe that when the books are written on this crisis it should be known as the “Crisis of Unintended Consequences.”

As of this writing California, the 8th largest economy in the world, is having financial difficulty again and its financial mismanagement is on display as it has started issuing IOUs to cover some of its bills. California is at the epicenter of the housing crisis and its unemployment rate is 11.5%. This brings back memories of NYC in 1975, but the markets seem not to be concerned. I guess the logic is that if the government bails out Wall Street and the UAW with U.S. taxpayer funded debt, it is not going to walk away from the most populous state in the nation with 55 Electoral College votes and the Speaker of the House amongst the California congressional delegation. States and municipalities are the next phase of the crisis as tax revenues decline faster than services can be cut. Stay tuned.

OUTLOOK

We are not out of the woods yet and this country has structural problems/ issues that are not going to magically disappear or be solved without some difficult decisions being made. However, when “The Great Recession” ends our base case calls for the economy to experience below trend growth for an extended period of time. This view is driven by four main trends that we envision: less consumption; less leverage; more regulation; and higher taxes.

Drivers of Below Trend Future Growth

1	Less Consumption
2	Less Leverage
3	More Regulation
4	Higher Taxes

The markets will be looking for more than the “green shoots” of less bad being good and will look to the underpinnings of the economy and profits. The risk markets have started to pull back a bit as we enter earnings season and seem to be concerned about the macroeconomic backdrop and the fact that risk assets may have gotten ahead of themselves pricing in a strong recovery based on inventory rebuilding in the face of tepid final demand.

Our portfolios continue to favor and overweight the credit asset class with an emphasis on defensive industries focused on what consumers need rather than what consumers want such as consumer staples, regulated utilities and pipelines. We continue to be underweight U.S. Treasuries and government agencies.

We will be focused on the outlooks provided by corporate CEOs/CFOs as their 2nd quarter results are released. The overarching themes from the prior quarter were: top line growth was flat to negative with limited visibility; emphasis on cost cutting and aggressive inventory management; and liquidity, balance sheets and financial flexibility.

Exhibit 5: World's Largest Economies

Rank	Economy	GDP
1	 United States	14,264,600
2	 Japan	4,923,761
3	 People's Republic of China	4,401,614*
4	 Germany	3,667,513
5	 France	2,865,737
6	 United Kingdom	2,674,085
7	 Italy	2,313,893
	California	1,846,757
8	 Russia	1,676,586
9	 Spain	1,611,767
10	 Brazil	1,572,839

Source: International Monetary Fund, Bureau of Economic Analysis

* Figure excludes Republic of China and the special administrative regions of Hong Kong and Macau.

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