

FORT DEARBORN INCOME SECURITIES INC
Form N-CSR
December 09, 2010

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED
MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file number: 811-02319

Fort Dearborn Income Securities, Inc.

(Exact name of registrant as specified in charter)

One North Wacker Drive, Chicago, IL 60606-2807

(Address of principal executive offices) (Zip code)

Mark F. Kemper, Esq.
UBS Global Asset Management (Americas) Inc.
One North Wacker Drive
Chicago, IL 60606-2807
(Name and address of agent for service)

Copy to:
Bruce Leto, Esq.
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2600 One Commerce Square
Philadelphia, PA 19103-7098

Registrant's telephone number, including area code: 212-821 3000

Date of fiscal year end: September 30

Date of reporting period: September 30, 2010

Item 1. Reports to Stockholders.

Fort Dearborn Income
Securities, Inc.
Annual Report
September 30, 2010

Fort Dearborn Income Securities, Inc.

November 12, 2010

Dear shareholder,

We present you with the annual report for Fort Dearborn Income Securities, Inc. (the "Fund") for the 12 months ended September 30, 2010.

Performance

For the 12 months ended September 30, 2010, the Fund returned 12.98% on a net asset value basis, and 17.71% on a market price basis. Over the same period, the Fund's peer group, as measured by the Lipper Corporate Debt Funds BBB-Rated median, posted a return of 14.74% on a net asset value basis, and 18.59% on a market price basis, while the Fund's benchmark, the Investment Grade Bond Index (the "Index"), gained 13.45%.^{*} (For more performance information, please refer to "Performance at a glance" on page 7.)

Fort Dearborn Income Securities, Inc.

Investment goal:

Current income consistent with external interest rate conditions and total return

Portfolio Manager:

Michael Dow
UBS Global Asset Management (Americas) Inc.

Commencement:

December 19, 1972

NYSE symbol:

FDI

Dividend payments:

Quarterly

On an NAV basis, the Fund underperformed its peer group and its benchmark during the reporting period. The Fund's slight underperformance during the review period was primarily attributable to the Fund's fees and expenses, which are not included in the Index return. During the period, neither the Fund nor the Index used leverage, though some funds in its Lipper peer group may use leverage. (Leverage magnifies returns on both the upside and on the downside, creating a wider range of returns.)

The Fund traded at a discount to its NAV per share during the 12-month reporting period. During that time, the Fund's average discount was 9.9%, which was greater than the median discount of 5.1% of its Lipper peer group over the same period, according to data provided by Lipper, Inc. As of September 30, 2010, the Fund was trading at a discount of 6.9%, while the median discount of its Lipper peer group was 3.3%.

^{*} The Investment Grade Bond Index is an unmanaged index compiled by the Advisor, constructed as follows: From 12/31/81 to present—5% Barclays Capital US Agency Index (7+ years), 75% Barclays Capital US Credit Index (7+ years), 10% Barclays Capital US MBS Fixed Rate Index (all maturities) and 10% Barclays Capital US Treasury Index (7+ years). Investors should note that indices do not reflect the deduction of fees and expenses.

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A fund trades at a discount when the market price at which its shares trade is less than its NAV per share. Alternately, a fund trades at a premium when the market price at which its shares trade is more than its NAV per share. The market price is the price the market is willing to pay for shares of a fund at a given time, and may be influenced by a range of factors, including supply and demand and market conditions. NAV per share is determined by dividing the value of the Fund's securities, cash and other assets, less all liabilities, by the total number of common shares outstanding.

An interview with Portfolio Manager Michael Dow

Q. How would you describe the economic environment during the reporting period?

A. While certain economic data moderated toward the end of the review period, the economy, overall, continued to expand. The recession that started in December 2007 ended in June 2009, making it the longest since World War II.¹ Economic growth was supported by the federal government's \$787 billion stimulus program, increased consumer spending and improved manufacturing activity, as companies moved to rebuild inventories amid rising demand.

Q. How did the Federal Reserve Board (the "Fed") react to the economic environment?

A. Although the economy continued to moderately expand during the reporting period, the Fed remained concerned about elevated unemployment, which stood at 9.6% at the end of September 2010. As a result, the Fed maintained its highly accommodative monetary policy, keeping the fed funds rate within a range of 0.00% to 0.25%—an historic low. (The federal funds rate, or "fed funds" rate, is the rate that banks charge one another for funds they borrow on an overnight basis.) The Fed has now held short-term interest rates steady since December 2008. At its meeting in September 2010, the Fed said that "the pace of recovery in output and employment has slowed in recent months.... The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations,

¹The National Bureau of Economic Research (NBER) defines economic recession as: "a significant decline in the economic activity spread across the economy, lasting more than a few months, normally visible in real GDP growth, real personal income, employment (non-farm payrolls), industrial production and wholesale/retail sales."

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are likely to warrant exceptionally low levels of the federal funds rate for an extended period.

During a speech in October 2010 (after the reporting period ended), Fed Chairman Bernanke expressed concerns regarding the current state of the overall economy. He also alluded to the possibility of another round of quantitative easing, saying that the Fed is prepared to provide additional accommodation if needed to support the economic recovery and to return inflation over time to levels consistent with our mandate. It was no surprise then, when, in November, the Fed announced it would purchase an additional \$600 billion of longer-term US Treasury securities by the end of the second quarter of 2011.

Q. How did the bond market perform during the reporting period?

- A. The US bond market produced positive results with many spread sectors (non-Treasuries) generating strong returns over much of the reporting period. Supporting the spread sectors was the Fed's ongoing commitment to keep short-term interest rates at historically low levels. As a result, some investors were willing to assume greater risks in order to generate additional income from their investments.

Strong demand for the spread sectors diminished in May and August, in the wake of the sovereign debt crisis in Europe and concerns regarding the sustainability of the US economic recovery. However, risk aversion proved to be only temporary, as investors again returned to the spread sectors in June, July and September in order to capture the potential for higher yields. Overall, for the 12 months ended September 30, 2010, the US bond market, as measured by the Barclays Capital US Aggregate Index,² returned 8.16%.

Q. How did you manage the Fund's duration during the reporting period?

- A. We tactically adjusted the Fund's duration, which measures a portfolio's sensitivity to changes in interest rates, over the reporting period. During the first half of the review period, the Fund's duration was largely in line with the Index. In March 2010, we shortened the Fund's

²The Barclays Capital US Aggregate Index is an unmanaged broad-based index designed to measure the US dollar-denominated, investment grade, fixed-rate taxable bond market. The Index includes bonds from the Treasury, government-related, corporate, mortgage-backed, asset-backed and commercial mortgage-backed sectors. US agency hybrid adjustable rate mortgage (ARM) securities were added to the Index on April 1, 2007. Investors should note that indices do not reflect the deduction of fees and expenses.

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duration slightly, relative to the Index, in anticipation of interest rates rising, given signs that the economy was strengthening. As the review period progressed and economic conditions weakened, we adjusted the Fund's duration back to a neutral position versus the Index. Overall, the Fund's duration had a minimal impact on its performance during the review period.

Q. How did the Fund's yield curve positioning affect performance during the review period?

A. On an overall basis, the Fund's yield curve positioning slightly detracted from results. (The yield curve plots the interest rates, at a set point in time, of bonds having equal credit quality, but different maturity dates.) When the review period began, the yield curve was fairly steep. Given our expectations for the yield curve to flatten, we were overweight to the over 10-year portion of the curve and underweight to the five- to eight-year segment of the curve. This positioning was not initially rewarded, because the yield curve steepened further during the first half of the period, as short-term rates were largely anchored by the Fed's assurances that it would keep the fed funds rate unchanged. In contrast, longer-term rates moved higher, given expectations for future inflation.

However, the yield curve subsequently flattened in the second half of the review period as the economy weakened and there were expectations that the Fed would initiate another round of quantitative easing. As such, our yield curve flattening bias was beneficial as longer-term yields declined more than their short-term counterparts. Toward the end of the period, we modified the Fund's yield curve exposure to be more in line with the Index due to uncertainty around the implementation of additional monetary accommodation.

Q. How did you manage the Fund's portfolio during the reporting period?

A. As discussed, investor risk appetite was robust during much of the reporting period, given the low interest rate environment. As such, the spread sectors generally outperformed Treasuries during the reporting period. Against this backdrop, the Fund's overweight to the spread sectors was largely beneficial for performance.

Within the spread sectors, the Fund's out-of-index exposure to commercial mortgage-backed securities (CMBS) was the largest contributor to results. We were drawn to this sector given its attractive valuations and what we felt was a compelling risk/reward opportunity. CMBS performed well, in part, due to signs that the commercial real

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estate market may be stabilizing. In addition, investor demand for CMBS was strong, given their attractive yields. Security selection within the CMBS sector was also positive for performance, as we emphasized higher-quality issues that were often at or near the top of the capital structure since we found them attractively valued.

The Fund's out-of-index asset-backed securities (ABS) exposure also enhanced its results. Throughout the period, we emphasized BBB-rated credit card receivables since they continued to perform well as their spreads—the difference between the yields paid on these securities versus those paid on US Treasuries—narrowed.

The Fund's individual corporate bond holdings produced mixed results whereas relative corporate sector allocation was a negative contributor to performance during the period. In particular, the Fund's overweight to financials hurt performance, as their spreads meaningfully widened during the flights to quality, despite spread tightening during other times within the review period. However, the negative effects of this overweight position were largely offset by strong security selection. For example, the Fund's individual corporate bond positions within the financial sector and, to a lesser extent, the industrial sector, were beneficial for results.

Q. Were there any adjustments made to the Fund's positioning during the reporting period?

A. We modestly reduced the Fund's overall credit quality in order to capture high yields. We also pared the Fund's exposure to Treasury securities during the second half of the period, as their yields fell to historically low rates and we found more attractive opportunities in the spread sectors. Overall, these adjustments contributed to performance during the fiscal year.

Q. What factors do you believe will affect the Fund over the coming months?

A. Despite signs of moderating economic growth and continued pockets of weakness, we do not feel that the US will experience a double-dip recession. We also feel that the Fed's quantitative easing efforts will be supportive of an ongoing, albeit tepid, economic expansion.

Against this backdrop, it is our belief that Treasury yields will remain low, thus spurring continued strong investor demand for the spread sectors. We believe the Fund is well-positioned as we continue to overweight spread sectors.

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We thank you for your continued support and welcome any comments or questions you may have. For additional information regarding the Fund, please contact your Financial Advisor, or visit us at www.ubs.com/globalam-us.

Sincerely,

Mark E. Carver
President
Fort Dearborn Income Securities, Inc.
Managing Director
UBS Global Asset Management (Americas) Inc.

Michael Dow
Portfolio Manager
Fort Dearborn Income Securities, Inc.
Head of US Long Duration Fixed Income
UBS Global Asset Management (Americas) Inc.

This letter is intended to assist shareholders in understanding how the Fund performed during the 12 months ended September 30, 2010. The views and opinions in the letter were current as of November 12, 2010. They are not guarantees of future performance or investment results and should not be taken as investment advice. Investment decisions reflect a variety of factors, and we reserve the right to change our views about individual securities, sectors and markets at any time. As a result, the views expressed should not be relied upon as a forecast of the Fund's future investment intent. We encourage you to consult your financial advisor regarding your personal investment program.

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Performance at a glance (unaudited)

Average annual total returns for periods ended 9/30/2010

Net asset value returns	1 year	5 years	10 years
Fort Dearborn Income Securities, Inc.	12.98%	7.39%	7.57%
Lipper Corporate Debt Funds BBB-Rated median	14.74%	6.20%	6.82%

Market price returns

Fort Dearborn Income Securities, Inc.	17.71%	8.55%	8.59%
Lipper Corporate Debt Funds BBB-Rated median	18.59%	7.06%	8.08%

Index returns

Investment Grade Bond Index ⁽¹⁾	13.45%	7.00%	7.95%
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Past performance does not predict future performance. The return and value of an investment will fluctuate so that an investor's shares, when sold, may be worth more or less than their original cost. The Fund's net asset value ("NAV") returns assume, for illustration only, that dividends and other distributions, if any, were reinvested at the NAV on the payable dates. The Fund's market price returns assume that all dividends and other distributions, if any, were reinvested at prices obtained under the Fund's Dividend Reinvestment Plan. Returns do not reflect the deduction of taxes that a shareholder would pay on Fund dividends and other distributions, if any, or the sale of Fund shares.

Lipper peer group data calculated by Lipper Inc.; used with permission. The Lipper median is the return of the fund that places in the middle of the peer group.

⁽¹⁾ The Investment Grade Bond Index is an unmanaged index compiled by the Advisor, constructed as follows: From 12/31/81 to present 5% Barclays Capital US Agency Index (7+ years), 75% Barclays Capital US Credit Index (7+ years), 10% Barclays Capital US MBS Fixed Rate Index (all maturities) and 10% Barclays Capital US Treasury Index (7+ years). Investors should note that indices do not reflect the deduction of fees and expenses.

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Portfolio statistics (unaudited)

Characteristics ⁽¹⁾	09/30/10	03/31/10	09/30/09
Net asset value	\$17.35	\$16.22	\$16.50
Market price	\$16.15	\$14.67	\$14.85
12-month dividends/distributions	\$1.1940	\$1.0340	\$0.7200
Dividend/distribution at period-end	\$0.2500	\$0.2000	\$0.1700
Net assets (mm)	\$152.2	\$142.3	\$144.8
Weighted average maturity (yrs.)	16.1	18.0	17.9
Modified duration (yrs.) ⁽²⁾	9.0	8.5	8.9

Credit quality ⁽³⁾	09/30/10	03/31/10	09/30/09
AAA	15.1%	18.6%	17.8%
AA	6.8	6.1	8.9
A	34.3	34.7	36.6
BBB	37.3	36.3	33.6
BB	0.6	0.5	0.6
B	0.1	0.2	□
CCC and Below	□	0.0	0.2
Non-rated	2.4	1.5	0.3
Cash equivalents	2.2	1.4	0.9
Other assets, less liabilities	1.2	0.7	1.1
Total	100.0%	100.0%	100.0%

(1) Prices and other characteristics will vary over time.

(2) Modified duration is the change in price, expressed in years, expected in response to each 1% change in yield of the portfolio's holdings.

(3) Weightings represent percentages of net assets as of the dates indicated. The Fund's portfolio is actively managed and its composition will vary over time. Credit quality ratings shown are based on those assigned by Standard & Poor's, a division of the McGraw-Hill Companies, Inc. (S&P), to individual portfolio holdings. S&P is an independent ratings agency.

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Industry diversification

As a percentage of net assets

As of September 30, 2010 (unaudited)

Bonds

Corporate bonds

Aerospace & defense	0.71%
Auto components	0.50
Automobiles	0.76
Banks	0.51
Beverages	0.54
Biotechnology	0.60
Building materials	0.34
Capital markets	3.14
Chemicals	0.86
Commercial banks	5.66
Commercial services & supplies	1.37
Communications equipment	0.89
Consumer finance	1.64
Diversified financial services	7.38
Diversified telecommunication services	5.26
Electric utilities	6.02
Energy equipment & services	0.76
Food & staples retailing	2.80
Food products	1.26
Health care providers & services	1.45
Household durables	0.36
Insurance	4.16
Leisure equipment & products	0.25
Media	5.43
Metals & mining	1.18
Multiline retail	0.48
Multi-utilities	0.75
Office electronics	0.41
Oil, gas & consumable fuels	8.14
Paper & forest products	0.20
Pharmaceuticals	2.57
Real estate investment trust (REIT)	0.49
Road & rail	1.01
Software	0.45
Tobacco	1.94
Wireless telecommunication services	1.29

Total corporate bonds	71.56%
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Asset-backed securities	1.00
Commercial mortgage-backed securities	1.81
Mortgage & agency debt securities	4.81
Municipal bonds	5.50

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Industry diversification (concluded)

As a percentage of net assets

As of September 30, 2010 (unaudited)

Bonds (concluded)

US government obligations	9.64%
Non US-government obligations	2.27
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Total bonds	96.59%
Preferred stock	0.02
Short-term investment	2.17
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Total investments	98.78%
Cash and other assets, less liabilities	1.22
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Net assets	100.00%
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Portfolio of investments September 30, 2010

Security description	Face amount	Value
Bonds 96.59%		
Corporate bonds 71.56%		
Australia 0.33%		
Rio Tinto Finance USA Ltd., 9.000%, due 05/01/19	\$355,000	\$495,396
Bermuda 0.11%		
Validus Holdings Ltd., 8.875%, due 01/26/40	150,000	163,676
Brazil 0.26%		
Petrobras International Finance Co., 6.875%, due 01/20/40	350,000	400,660
Canada 2.22%		
Anadarko Finance Co., Series B, 7.500%, due 05/01/31	490,000	529,940
Canadian National Railway Co., 6.900%, due 07/15/28	285,000	366,509
Canadian Natural Resources Ltd., 5.850%, due 02/01/35	435,000	463,867
EnCana Corp., 6.500%, due 05/15/19	440,000	538,597
Petro-Canada, 6.800%, due 05/15/38	520,000	616,392
Teck Resources Ltd., 10.750%, due 05/15/19	184,000	231,711
TransCanada PipeLines Ltd., 7.125%, due 01/15/19	500,000	633,485
Total Canada corporate bonds		3,380,501
Cayman Islands 1.28%		
Transocean, Inc., 6.800%, due 03/15/38	535,000	548,594

7.500%, due 04/15/31	575,000	601,041
Vale Overseas Ltd., 4.625%, due 09/15/20	765,000	790,122
Total Cayman Islands corporate bonds		1,939,757
France 0.26% Electricite De France, 5.600%, due 01/27/40 ⁽¹⁾	350,000	388,576

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Portfolio of investments September 30, 2010

Security description	Face amount	Value
Bonds (continued)		
Corporate bonds (continued)		
Isle of Man 0.17%		
AngloGold Ashanti Holdings PLC, 5.375%, due 04/15/20	\$250,000	\$264,471
Luxembourg 1.24%		
Covidien International Finance SA, 4.200%, due 06/15/20	440,000	468,958
Enel Finance International SA, 6.000%, due 10/07/39 ⁽¹⁾	365,000	377,382
Telecom Italia Capital SA, 6.375%, due 11/15/33	1,060,000	1,045,666
Total Luxembourg corporate bonds		1,892,006
Malaysia 0.13%		
Petronas Capital Ltd., 5.250%, due 08/12/19 ⁽¹⁾	175,000	195,534
Mexico 0.93%		
America Movil SAB de CV, 5.000%, due 03/30/20	625,000	674,086
Pemex		