Municipal Market | ADVISORS

NOVEMBER 2008

GAIN INSIGHT ON HOW TO NAVIGATE THE COMPLEX MUNICIPAL BOND MARKET

ABOUT US

Municipal Market Advisors is a leading independent strategy, research and consulting firm in the municipal bond industry. MMA's subscription services provide *clarity* and *insight* into the complex world of municipal bond investing. Our independence facilitates objective analysis and distinctive views of the issues confronting investors so informed investment decisions can be made.

WHAT WE OFFER

- MMA's subscription services provide timely independent unbiased market coverage delivered intraday, daily and weekly via internet, email, Bloomberg and PDA.
- Cost effective solution to monitoring and understanding "The Market".
- Interaction with regulators, Congressional leaders and Central Banks provides unique insight.

CONTACT US

For Full Muni Outlook and additional information on how our advisory or subscription services can add value to your portfolio, please contact Steve McLaughlin at 973-701-1111 or log on to www.mma-research.com and sign on for a free trial.

MARKET SUMMARY

MUNICIPALS SUPPORTED BY RETAIL AMID CHALLENGES

Individuals provided the support for a calendar of $23.5B of primary issuance, especially immediately after Barack Obama's convincing presidential victory and the anticipation of higher taxes. Strength persisted in the market through November 20, when the $149M VA Resource Authority loan marked the "top" of the market. Institutional demand remained absent for most of the month as the remaining leveraged accounts sold selectively, mutual funds maintained outflows and property & casualty companies remained sidelined by economic adversity.

The municipal market was still crippled by the inconsistent liquidity that has thwarted a comfortable transaction environment since early September. The reduced number of dealer participants and the cautious deployment of capital to the municipal bond sector has largely attributed to challenges for issuers to access the capital markets and institutions to find a representative bid for bonds in the secondary. The capital challenges facing dealers and dealer banks is illustrated by the number of leading institutions receiving "bailout" funds from the US government, **Figure 1**. On November 24, Citigroup was the recipient of $306B to provide relief from its toxic assets as well as a cash infusion. The turmoil in a firm which at one time was the largest underwriter of municipal debt as well as one of the biggest tender option bond programs highlighted the challenges in the tax-exempt industry.

The challenges to municipals were further exacerbated by the exceptional rally in the Treasury market. At month-end, Treasury yields had approached levels not attained in 50 years, while the 10-year penetrated the 3.00% barrier, shattering the 3.11% yield low of June 2003 (the last deflationary period). At month-end, the Treasury 10-year closed at 2.93% reducing its real-return to less than 1%, **Figure 2**. The flight-to-safety rally produced a near 100 bps rally for the month, and

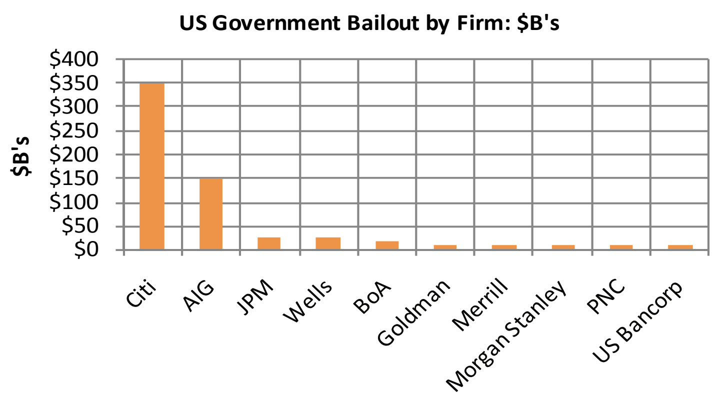


Figure 1: Citi's $306B rescue funds from the US government on November 24 pushed the firm above AIG as the largest bailout recipient.

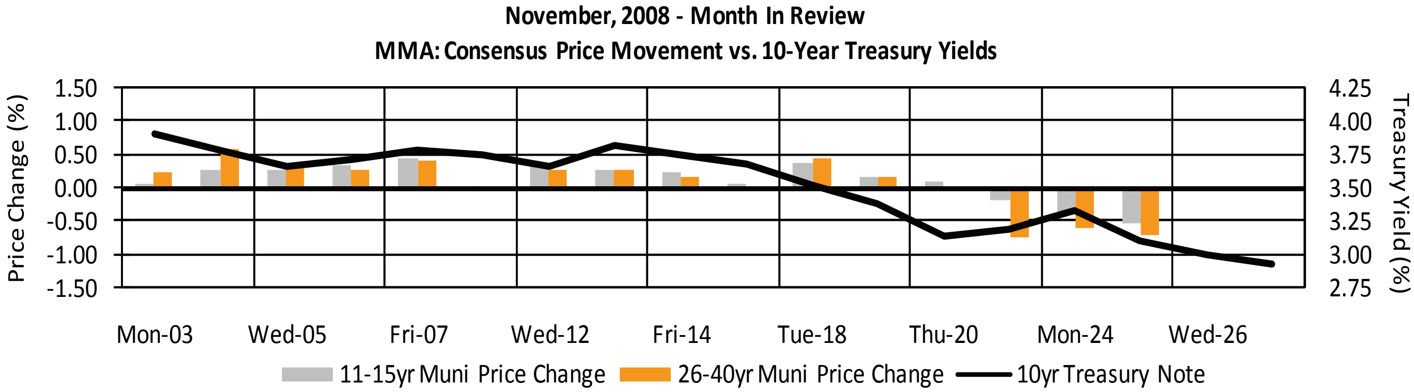
for institutions attempting to manage their municipal risk with taxable instruments, i.e. Treasuries or Libor, losses from such strategies were horrific. The reduced profitability from traditional trading and sales has only become more difficult with the absence of institutional demand as well as the near impossibility to hedge the downside price risk of municipals.

While the industry confronts the challenges of the "new normal" it appears evident that the costs associated with risks of the current environment will manifest in larger underwriting spreads and higher interest rates for issuers in order to entice individuals to the market.

CREDIT CONDITIONS - AMBIGUOUS

On November 4, Ambac's SR debt was cut by Moody's from Aa3 to Baa1, and on November 21, Assured's rating was cut from Aaa to Aa2 and FSA was reduced to Aa3. Assured purchased FSA on November 14, for $722M. Moody's actions left Berkshire's limited insurance unit as the lone AAA municipal insurer, and increased the likelihood that bond insurers would no longer capture a AAA rating. The demise of municipal bond insurance has left individuals at a loss as to how to assess the risks of municipal credit (as the prevalence

MUNI OUTLOOK FOR NOVEMBER



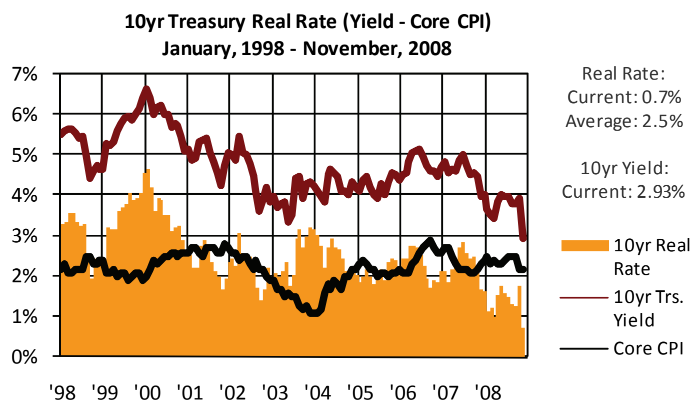


Figure 2: The increased demand for Treasuries prompted by a safety bid and amid the intensifying deflationary theme, drove the 10-year yield below 3% and real return below 1%.

of insurance commoditized the market). In November, it became more evident that issuers having less than a AA rating were penalized by higher interest rates or prohibited from access to capital. Going forward the municipal market will continue to be subject to the turbulence generated by headline risk as the US economy worsens, ratings risk as municipal issuers are downgraded (that could negatively impact performance and value of current holdings) and finally default risk should the US economy place enormous strain on weak issuers dependent on tax revenues. The National Association of State Budget Officers anticipate state budgets may reflect reduced spending for the first time since 1983.

The *Municipal Advisor* is prepared monthly by
Thomas G. Doe & MMA Team
978.287.0014
tdoe@mma-research.com