

GAIN INSIGHT ON HOW TO NAVIGATE THE COMPLEX MUNICIPAL BOND MARKET

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- 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.

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MARKET SUMMARY

WORST DECEMBER FOR MUNICIPALS IN 20 YEARS

MMA's municipal price index posted a -2.8% loss, surpassing the prior largest losses for December in 1996, 2001 and 2006. The month's poor performance followed a historically weak November so that municipal investors were left confused into year-end. Similar to periods when December was unable to follow its seasonal positive bias, the combination of a perceived change in FOMC monetary policy, an improving economy, credit concerns and above average primary issuance resulted in price losses and negative total rate of return. Participants were focused on the potential constructive contribution to US economic growth from the Federal Reserve's QE (\$600B Treasury buyback) as well as the extension of the Bush tax cuts. The Congressional negotiations regarding the tax cut extensions also provided the continuation of jobless benefits, but at the cost of the loss of the Build America Bond (BAB) program. The increased concerns regarding both federal and state budget adversity (highlighted by drastic recommendations from the administrations bipartisan deficit-cutting commission, which included the end to tax-exempt bonds) contributed to weakened support for BAB's especially since the industry was unable to provide Congress with a breakeven subsidy. There was some rumbling from Rep. Mica (R-FL) for a reintroduction of the program in 2011, but an exchange on the op-ed pages of the WSJ at year-end suggested there was less veracity behind the program's re-introduction than would be needed for success. The probability of the non-extension led to more than \$16B in BAB issuance in December and more than \$40B municipals issued in total. The heavy primary calendar was combined with the continued exodus of investors from bond funds, and specifically tax-exempt funds (7 consecutive weeks of nearly \$14B) placed considerable stress on the limited capital for liquidity. As a result, tax-exempt yields rose sharply contributing to December's record losses. However, the weakness was not as great as 1994, when over a 7 week period from February to April MMA's municipal price index lost more than -10%, **Figure 1**. At that time, the municipal market failed to recover through the summer even though there was support from large June and July reinvestments. Also in December, Meredith Whitney appeared on "60 Minutes" and

Municipal Market Adversity: February-June 1994
Cumulative Price Change v. 10-year AAA GO Yield

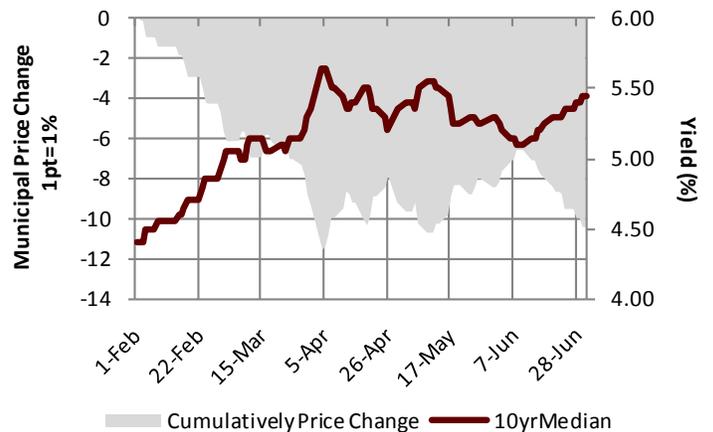


Figure 1: In Spring 1994, municipal prices fell more than -10% in 7 weeks.

Credit Default Profile of Municipal Industry
% Municipal Bonds in Default Since July 2009

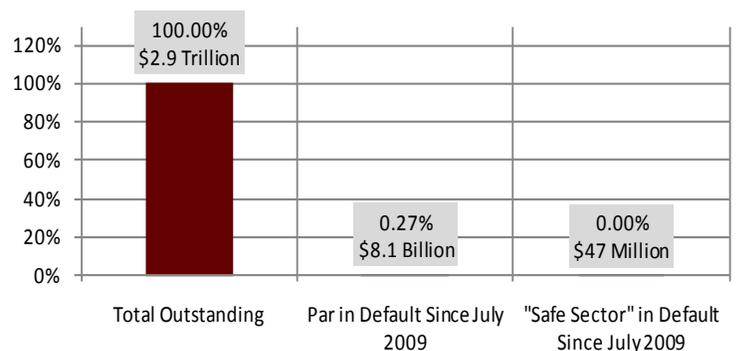


Figure 2: Municipal safe sector defaults have been a mere \$47M since July 2009.

MUNI OUTLOOK FOR DECEMBER 2010

restated her position that there would be 50-100 defaults of more than \$100B in the next 12 months. Her forecast and 2 years of “research” on the topic, would be best suited for equity short-sellers seeking the collapse of companies adversely impacted by crumbling states. Whitney’s public relations blitz may be the “tipping point” for states and local governments to address the significant pension liabilities (that serve as the fundamental basis for the default projections). Indeed, pension reform has become increasingly politically popular and 2011 could represent a breakthrough in addressing the fiscally detrimental entitlement. **MMA’s** credit impairment database reflects that only \$8B (282 issues) have defaulted in the past 18 months of which a mere \$43M (3 issues) are safe sector credits, **Figure 2**. There is little question that adversity among municipalities could lead to more defaults but it is unlikely to reach the magnitude of Whitney’s forecast. Of note at month-end, was the end of the lawsuit of by major banks against MBIA, which could lead to the insurer returning actively to the municipal market. The illiquidity in the

municipal market emphasized the distribution problems in the industry that also contributes to greater underwriting risk, price volatility and potentially greater disparity between investors’ statement evaluations and executions prices. The latter issue serving as a critical consequence that could undermine the industry’s integrity and lead to greater liquidations from funds. The prospect of a high percentage of the \$288B two year increase in household and fund municipal holdings exiting the market could place extreme pressures on dealers capital and issuers accessibility to favorable yield levels. The reallocation of assets away from tax-exempts could well grow should US equities’ rally extend into and through 2011.

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