GAIN INSIGHT ON HOW TO NAVIGATE THE COMPLEX MUNICIPAL BOND MARKET

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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.

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- 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 NOVEMBER PERFORMANCE IN RECENT HISTORY

The municipal market performed atypically in November - posting a negative month of performance. Historically, the seasonal bias is positive. MMA's municipal price index posted a loss of -2.98%, eclipsing the prior worst November's of 1993, -1.9% and 1994, -2.3%. Historical severe price declines have often been associated with restrictive monetary policies. The catalyst in 2010 was an apprehensive response by the fixed-income markets to the potential inflationary risks associated with the FOMC's $600B in additional quantitative easing (QE). The losses were exacerbated by the first meaningful municipal bond redemptions in 2 years. The limited capital in the dealer community was insufficient to provide adequate liquidity and the yield rise in municipal indices matched those of the most adverse periods in history, Figure 1. Coincidently, the 90 bps rise in the Bond Buyer 20 Index yield was comparable to the spike in Spring 1986, following a Congressional threat to end municipal tax-exemption. The most severe distress and withdrawals occurred after S&P downgraded 50% of the outstanding municipal tobacco loans to "junk." The market response was swift and penal as those tobacco credits not backed by state appropriations experienced yield evaluations 80 bps higher in the session following the announcement, November 12, Figure 2. The negative price action contributed to sharp adjustment in bond funds whose portfolios were over-weighted to the sector. Unfortunately for the broader market these same funds were among the top performers at the end of 3Q, and given the credit sensitivity and media attention on default risk, the sharp downward adjustments in NAV contributed to investor redemptions. One of the leading high-yield funds lost all of its returns of 2010 during November, and industry outflows for the following week after the S&P downgrade were in excess of $4B, according to the ICI.

November municipal issuance was approximately $42B, of which $17B was represented by Build America Bonds (BAB's). The supportive comments from Republican leadership that the program could be extended was embraced by the industry, while the prospects of a lower subsidy created incentive for issuers to capture the greater Federal subsidy, 35%. The intensity of the po-

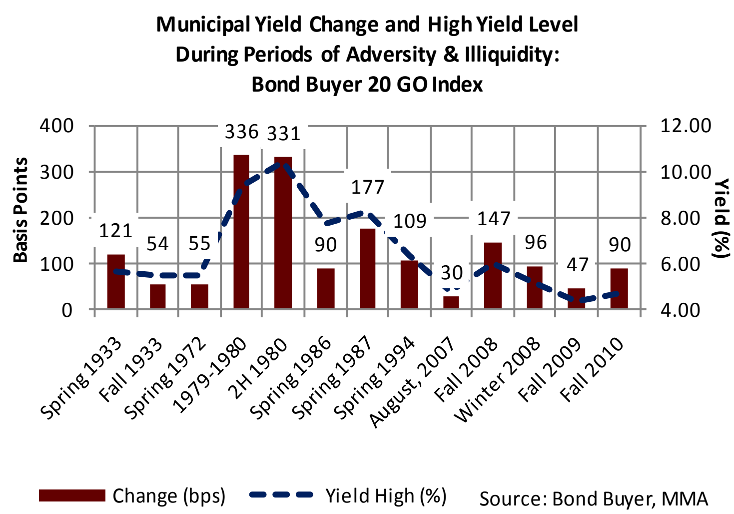

Figure 1: Fall 2010 was comparable to prior periods of illiquidity caused by an imbalance between secondary or primary supply and demand.

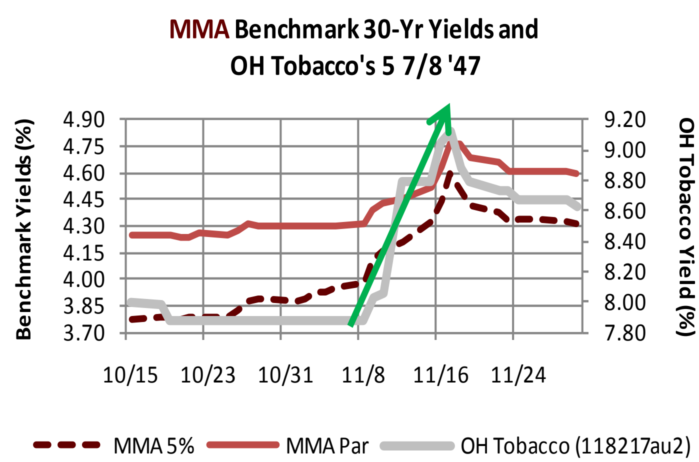

Figure 2: S&P's downgrade of tobacco credits on November 11, proved penal as affected issues experienced an 80 bps rise in yields on November 12.

MUNI OUTLOOK FOR NOVEMBER 2010

litical debate regarding the extension of the Bush tax-cuts and the administrations' deficit commissions suggestion to end federal exemption for municipal bonds dominated the themes emanating from Congress's "lame-duck" session in November. The month's issuance made the 12-month rolling total $387B, and the non-BAB issuance total fell to $288B. Tax-exempt issuance has now returned to the pace of the pre-TOB era (i.e. 2002). Total BAB issuance rose above $170B.

As evidenced by the tobacco downgrade, the industry's susceptibility to negative credit headlines remained significant. The large issuance by Illinois and California placed even greater emphasis on state budget issues in the media (see MMA in the News). At month-end, the National Association of State Budget Officers forecasted that 23 states will experience budget gaps of a cumulative $40.5B in fiscal year 2012. Of historical note, one of the worst December's for municipals on record was in 2001; when coincidently, along with concerns of a more restrictive FOMC monetary policy was Moody's downgrade of its entire state sector outlook to negative from stable. The action was in response to the expected FY 2002 budget deficits of $40-50B. December has been generally favorable to the municipal bond market. Finally, a significant challenge to the municipal market remains the competition from other investment alternatives, i.e. equities. YTD US equity indices remained positive and over the past 3 months the Nasdaq has led returns, posting an 18.17% gain. International concerns regarding European banks (i.e. Ireland) persisted while N. Korea 's military actions raised tensions in Asia and those countries holding the most US Treasury debt.

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