MMA The Power of Independence

APRIL 2012

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".
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MARKET SUMMARY

MUNICIPAL PERFORMANCE FOLLOWED APRIL FORM

After the March Non-farm payroll report was released on April 6, the MMA municipal price index returned to a positive trend and sustained a constructive tone until the end of the month, when the Index fell to neutral. Nonetheless, MMA's price index posted a gain in excess of 1.5%, consistent with the month's historical bias since 2002. The advance was assisted not only by the continued inflows to funds and bank buying, but also an unusually high degree of inter-dealer trading (which represented 20% of secondary activity as compared to April's 15% average since and including 2007). The continued ambiguity regarding the outlook for the US economy, Federal Reserve policy (particularly an enactment of QEIII) and resolution to the EU debt crisis bolstered the demand for safe fixed-income securities including municipal bonds. The municipal market's price pattern in 2012 has been similar to that of 2009, when there was an unusually consistent demand for tax-exempts; (Figure 1) and issuers enjoyed unusually aggressive relative pricing and market access. In 2009, demand was spurred by high yields following the 2008 TOB deleveraging. In 2012, bank and crossover demand have increased interest in municipals and has been complemented by the sustained positive capital inflows into mutual funds. Municipal monthly issuance remained above $30B, $33.64B to increase the 12-month issuance pace to more than $340B, the highest non-BAB total since February 2010. The defining characteristic of the new supply was a high percentage of refundings. So while issuers took advantage of favorable market conditions to restructure outstanding debt there remained a relative dearth of new project financing. Not only were public leaders hesitant to increase debt burdens during the tentative economic recovery, but also investor demand has been constrained by reliance on traditional demand components—individuals, funds and bank portfolios. A contributing factor to municipal bonds' positive low default rate has been the limited traditional demand component linked to the specific investor advantage of the low tax-exempt rate. This characteristic has now become a challenge to the policy debate regarding infrastructure funding and tax-reform, page 10. In April, the political rhetoric regarding tax-exemption's cost and advocacy for a federally subsidized taxable program, failed

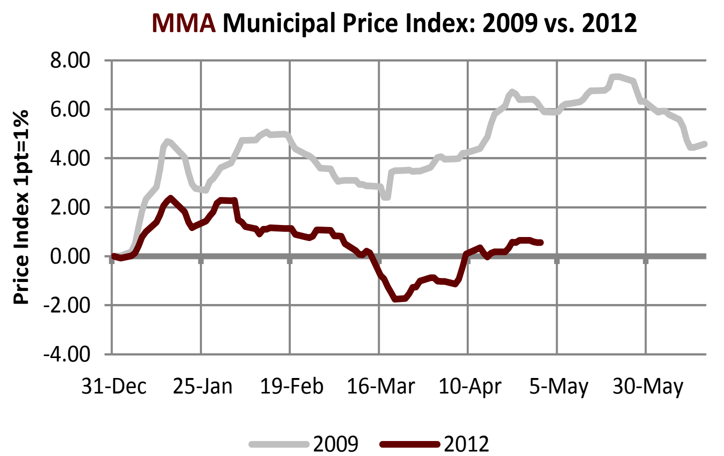

*Figure 1: In 2009 the initial rally in early January was far greater than the same period of 2012 (yields were far higher 3 years ago). However, the general price pattern is similar and now the sustained high ratios, ambiguous fundamental conditions and favorable supply/demand imbalance argue for a similar projected price pattern for municipals into June. Also, **MMA**'s Municipal Value Index in 2012 was last similarly as advantageous for issuers in 2009.*

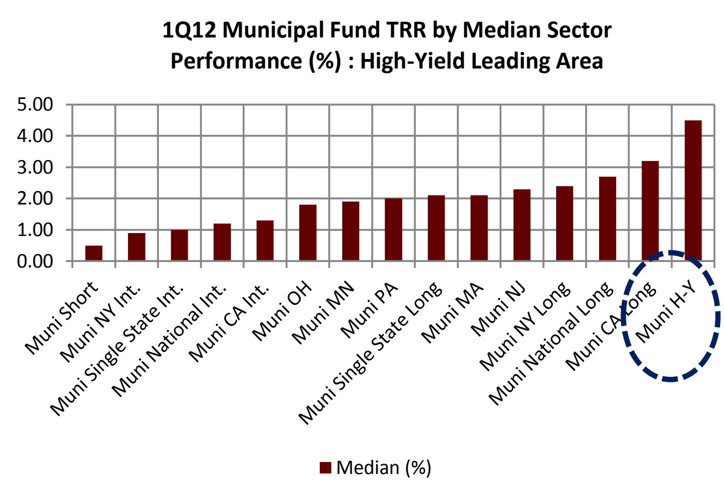

Figure 2: High-yield's leading returns have drawn investor cash, and enabled lower rated issuers access to capital at attractive rates. The leading 1Q12 returns were marketed aggressively by the leading fund families, whose returns were 66% greater than the median, perpetuating market access for challenged issuers.

to reveal the dilemma of policy makers who desperately want to fund job creating US public infra-structure projects (estimated in excess of $3T) but have no cash do so, and are frustrated by state and local municipalities' fiscal discipline to abstain from amplifying their debt burden. The result is at least a $2.7T infra-structure funding gap. The attention refocused policy-makers on US corporate cash as a source of capital for political needs was amplified by a NYT article on Apple's large overseas cash position and low tax payment rate.

The demand for yield resumed, and portfolio strategies extended further out the yield curve and lower down the rating scale. Lower rated issuers were able to gain attractive rates and access to capital, and provide product for the aggressively marketed high-yield mutual funds whose leadership defined 1Q12 returns, Figure 2. Indeed, early May's primary activity will be led by the $1.8B IL GO issue, an issuer that has defined "headline risk" for the industry, and is apt to benefit from favorable market conditions. Fundamentally, Spain's debt woes rekindled EU concerns and the US Treasury safety-bid. US corporate earnings and benign economic data enabled US equities to rebound at month-end from a weaker than expected March jobs number on April 6 that weighed on stocks.

The *Advisor* is part of the *Tier Subscription Packages* prepared monthly by:

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