UNIQUE OPPORTUNITIES TODAY FOR MUNICIPAL INVESTORS

HAVEN'T THOUGHT ABOUT MUNICIPAL BONDS LATELY?

YOU MAY BE MISSING A UNIQUE OPPORTUNITY.

A confluence of recent events has created a potential opportunity for investors ready to invest in the municipal market today. Read more to learn about the unique market events that we believe have created compelling near-term opportunities for municipal investors. You'll also learn about catalysts that may have a longer-tem impact for municipal investors.

THE SITUATION:

Supply in the municipal market has been at high levels, which enabled investors to find high quality municipal bonds at favorable yields. This increased supply, particularly at the long end of the yield curve, has been the result of the credit crunch sparked by the sub-prime mortgage meltdown beginning in 2007. We do not believe the increase in supply will last indefinitely.

THE BACKGROUND:

A confluence of negative events provided a unique market for municipal bond fund investors, which we believe still provides the following potential catalysts for the muni market.

#1 A failure in auction rate securities. During an extended period of a relatively flat yield curve, many investors seeking higher levels of income purchased short-term auction rate securities. Some funds used them as a means of leverage, which enabled the fund to buy additional longer term, higher yielding securities. A common misperception was that the auction rates were similar to money market securities. This was not the case, and in early 2008 the market for these securities became illiquid and investors were unable to unload the securities.

What it means for munis: The inability of funds to use auction rates as a means of leverage has reduced this demand for longer-term municipal bonds that had caused prices to fall and yields to rise.

#2 A downgrade in the credit quality of bond insurers. Municipal issuers have long used private insurance companies to guarantee the timely repayment of principal and interest should an issuer default. Obtaining insurance enabled issuers to provide bonds at a higher "perceived" credit rating and therefore pay a lower income stream for the life of the issue. In recent years, insurers dabbled outside the municipal market into lower quality securities, which began to unwind with the sub-prime mortgage crisis. As a result the insurers were downgraded in credit quality and the municipal issues they backed have also been deemed riskier by the market.

What it means for munis: Some high quality municipal issuers are being punished by the 'headline risk' of the insurance provider. Good underlying bonds are still valuable, and insurance only matters if the issuer defaults.

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#3 Lengthening maturities of short-term issues. Other types of short-term issuers were impacted by the auction rate failure and were forced to extend the maturities of their issues – from days to years in many cases – adding more supply to the market.

What it means for munis: Supply had increased dramatically in municipal issues in the longer maturity ranges, causing prices to decline and yields to rise.

#4 A deleveraging of hedge funds: As the credit market has dried up, many hedge funds have had to liquidate assets to fund investor redemptions, meet margin calls or reduce borrowings (leverage).

What it means for munis: A huge increase in supply of long-term municipal bonds hit the market in late 2008, which sparked declining prices and favorable yields.

THE OPPORTUNITY:

We believe the unnatural increase in supply will not last long. While demand had trouble keeping up with the supply flooding the market, demand remains strong from a historical perspective.

Ongoing drivers include: Baby Boomers, who are retiring and are expected to move greater portions of their portfolios into bonds. Some issuers delayed coming to the market in last fall's yield surge, yet still need the funding and may be attracted to the more recent moderation of rates. The tax rate is low from a historical perspective and there's speculation that it could move higher once the political focus moves from stimulus to paying for the stimulus.

THE TIMING:

As the new supply is absorbed, prices of municipal bonds are expected to rise. If you are considering municipal bonds, now may be an opportune time.

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