

Municipal Bonds Still Offer “Sneaky-Good” Value

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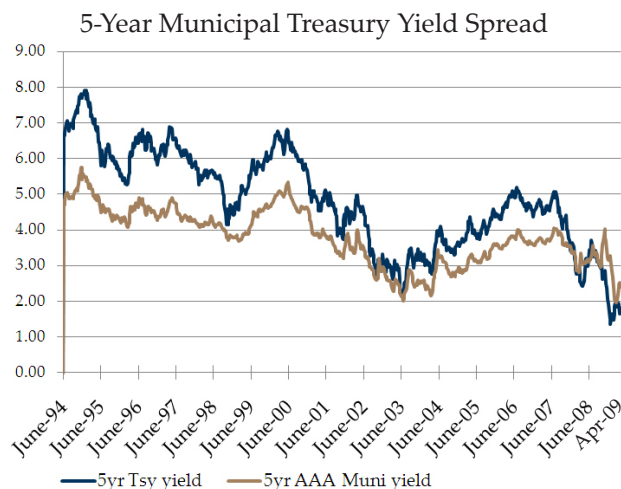
A Minute in the Market

Everybody knows that the past six months have been simply awful for most investors. There has been massive destruction of shareholder wealth, and even holders of high-quality financial sector bonds have absorbed substantial write-downs in the market value of their securities. At the same time, yields on U.S. Treasury securities have been driven to 75-year lows. Where is an investor to turn for reasonable yield along with stability of credit quality and market price? Our clients who hold municipal bonds already know the answer to that question. Municipal bonds have not shared fully in the price rally that has benefited U.S. Treasury securities. In fact, for some time they have been priced to yield 100% or more of comparably-maturing U.S. Treasury securities, notwithstanding their exemption from federal personal income tax. On the other hand, municipal bonds have not seen their market prices drop like financial-sector corporate bonds, and the tax adjustment adds substantially to their after-tax yield spread versus Treasuries and other taxable instruments such as corporate bonds.

SNW Asset Management has examined yields of municipal bonds rated low-double-A and high-single-A versus comparably-maturing U.S. Treasury securities as of June 30, 2008, September 30, 2008, December 31, 2008, and March 31, 2009. Our current recommendation is to keep maturities relatively short in order to avoid locking in long-term yields at current ultra-low levels. To be consistent with this recommendation, we looked at the yields for 3-year and 5-year maturities. What we found was that, while municipal yield spreads versus Treasuries peaked around year-end, they are still at *more than 100%* of Treasury yields and still at levels which are as good as they were at the end of the third quarter of 2008, after the Fannie Mae, Freddie Mac, AIG, and Lehman Brothers debacles. To put

this into perspective, since 1994, yields of five-year maturity municipals averaged only 82% of the yield on a similar maturity Treasury. Bottom line: municipal bond yields still price in a bit of investor panic, and they still offer excellent yields versus comparably-maturing Treasuries. How good? An investor can add an additional 0.5% to 1.0% of yield annually, which equates to 1.25% to more than 2.25% when adjusted for exemption from federal tax at 25% and 35%, respectively. For bondholders in states such as California, Idaho, and Oregon, where state income tax rates are substantial, the tax adjusted spreads are even higher on a tax-adjusted basis, because in-state securities are also exempt from state tax.

At SNW Asset Management, we believe that this attractive and substantial pickup in yield can be achieved without assuming material investment risk. We are talking about relatively short-maturing bonds rated A1/A+ or better. Bonds of this kind have so far held their credit ratings and their market values extremely well, and we think they represent one of the best risk-adjusted opportunities available in today's fixed-income markets.



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SNW's Recent Municipal Underwritings

Amount (000's)	Issuer	Dated	Rating	2010	2011	2012	2013	2014	2015	2016	2017	2018
\$92,820	Central School District #13J, GO Series 2009, OR	4/22/2009	AA		1.100	1.300	1.540	1.890	2.140	2.360	2.580	2.800
\$30,000	Issaquah School District #411, UTGO Bonds, WA	4/21/2009	AA+	0.980			1.790	2.170	2.420	2.680	2.880	3.100
\$2,800	Ione School District #2, GO Series 2009, OR	4/7/2009	AAA	1.150	1.500	1.750	2.150	2.550	2.800	3.000	3.250	3.500

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