

### **The Muni Roller Coaster**

At the end of the second quarter and after the Fed made their infamous “Taper Talk”, retail investors made large redemptions from their Muni Bond Funds. The ensuing move higher in Muni yields was the largest 4 month move since before 1987. In September, the Fed surprised the markets again with their “No Taper” talk and redemptions slowed dramatically. Needless to say the market has moved like a roller coaster. We like using the volatility to add opportunistically.

### **Market Recap**

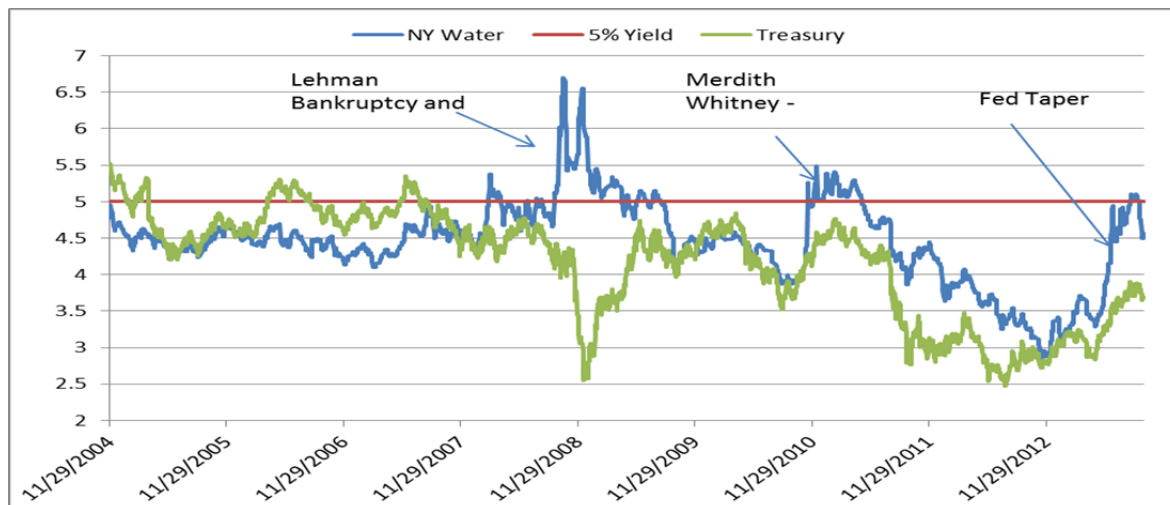
The table below summarizes year end, quarter end, and month end yield and spread closes for NY Water (a liquid AA rated Cpn Muni) and CA zeros (A+). As you can see, the yields and spreads have moved dramatically.

<b><i>Thirty Year Maturities</i></b>						
<b>Ratedate</b>	<b>Treasury</b>	<b>NY Water</b>	<b>Spd</b>	<b>Treas Strip</b>	<b>CA Zero</b>	<b>Spd</b>
12/30/2012	2.95	3.36	41.00	3.16	5.27	211.30
3/30/2013	3.11	3.66	54.60	3.35	5.23	187.60
6/30/2013	3.50	4.46	96.30	3.66	5.87	221.10
7/31/2013	3.65	4.68	103.50	3.81	6.13	232.20
8/30/2013	3.68	5.02	133.50	3.95	6.38	243.40
9/30/2013	3.69	4.56	87.00	3.98	6.11	213.00

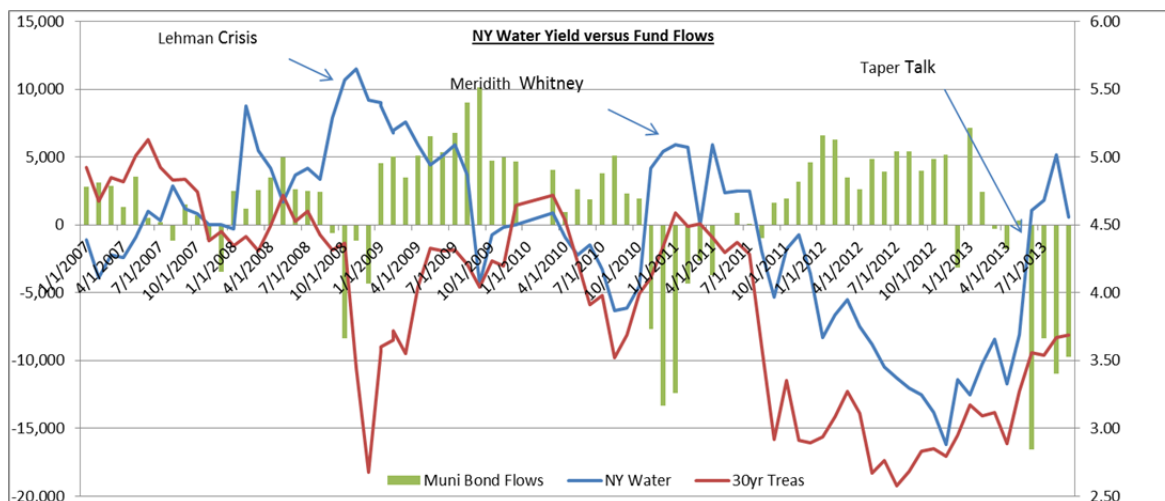
### **Going Forward**

In prior quarterly reviews we discussed five indicators we use to determine value in the Municipal space. We will review each of these indicators and make the case that Munis are cheap.

*Absolute rates* – Most investors buy Municipal Bonds for tax free income to support their lifestyle. As rates rise above 5%, retail investors have historically been aggressive buyers. Over the past ten years, even when Treasury rates (green line) were substantially higher, there have been limited times when investors could buy Munis at 5% yields.



It is interesting to note that the monthly redemptions continued to be negative each month after the June, 18 “taper talk” and during the weeks leading up to the September, 18 Fed meeting.

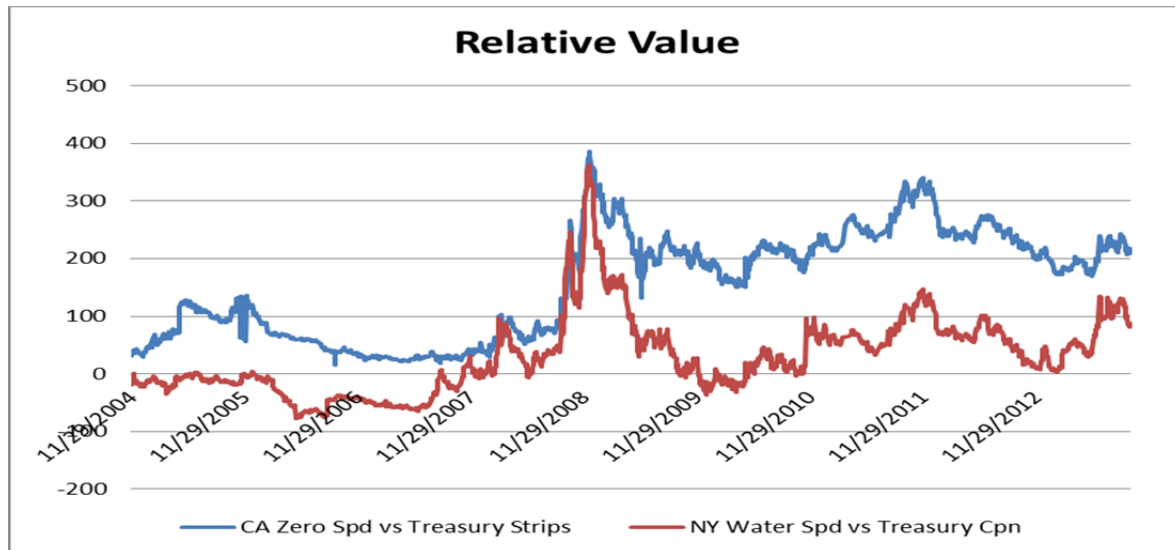


After the “No Taper” announcement on September 18, flows turned positive. We believe that as rates stabilize so will flows.

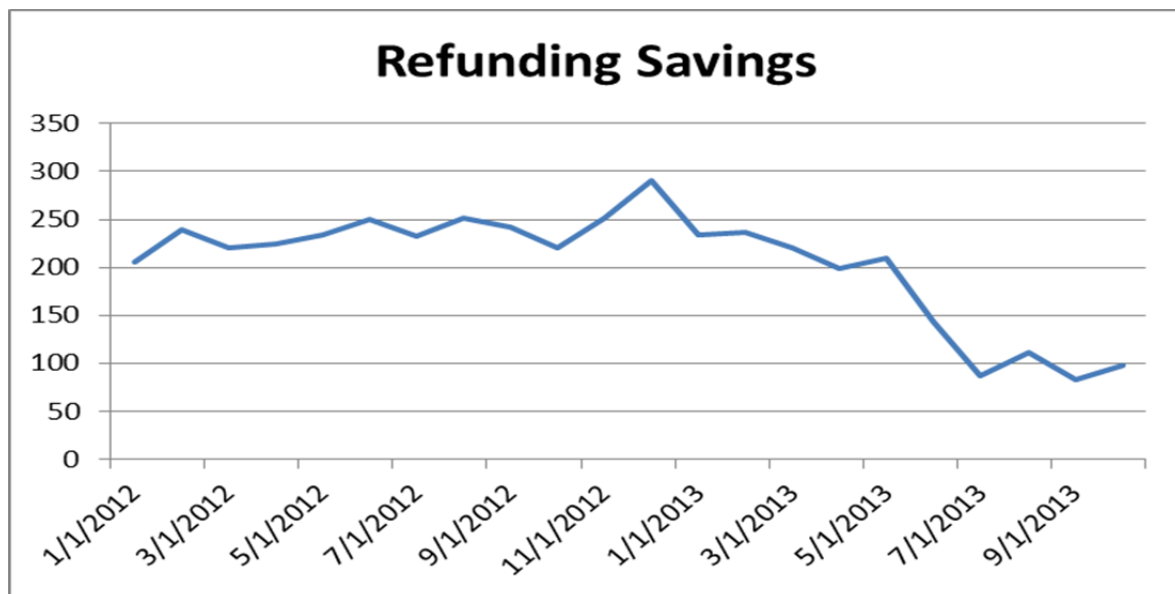
Dates	HY Muni Redemptions	Long Duration Muni Fund Redemptions
9/4/2013	-266	-955
9/11/2013	-749	-5,196
9/18/2013	181	-472
9/25/2013	399	239

*Relative Value* – Cross over buyers are those buyers that traditionally invest in the taxable markets, but aggressively “crossover” and buy Municipal debt when Muni yields are commensurate to yields on similar rated taxable debt. Outside of the “Lehman Crisis”, the NY Waters and other liquid cpn bonds have improved but are historically still very cheap relative to the taxable market. The Ca zeros have

improved nicely in reaction to Bill 182 which restricts any new issuance of long dated and non-callable Ca School zeros. Spreads on these bonds are still historically cheap.



*Supply* – Approximately half the outstanding municipal debt has coupons equal to or greater than 5%. As yields approach the 5% level, refunding supply drops precipitously. The graph below shows the historical “refunding spread” which measures the 30yr rates from 10 years ago to today’s 20yr rate. As you can see the refunding savings has dropped dramatically.

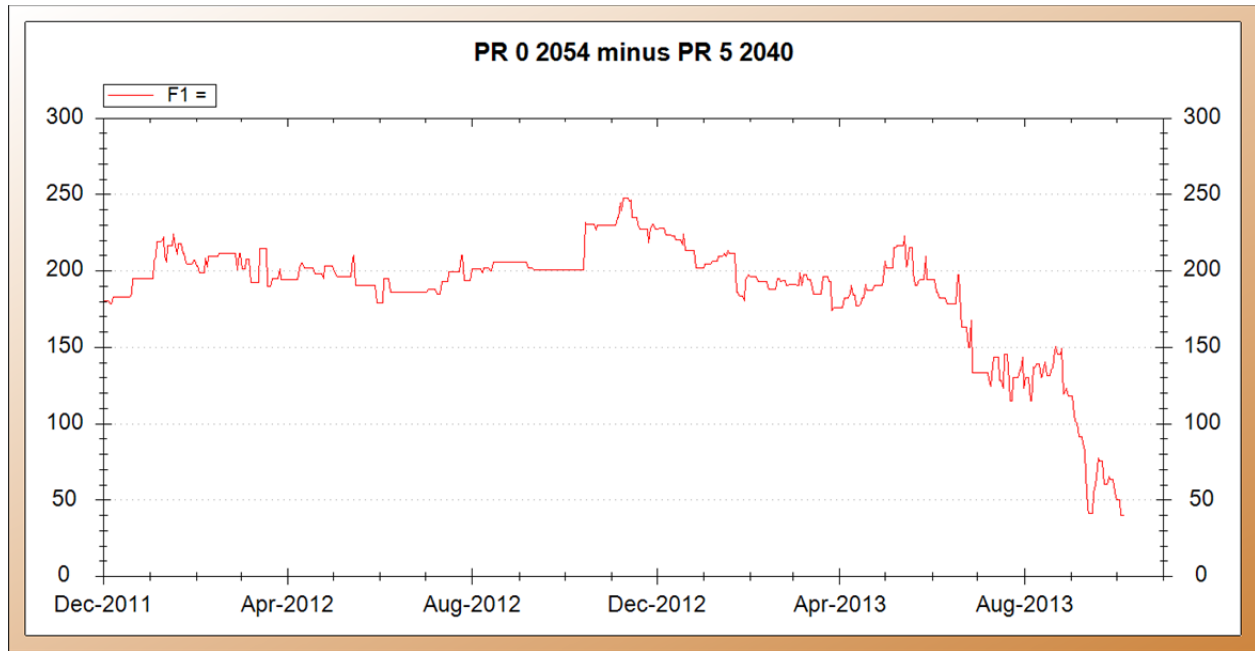


Not surprisingly, so has the amount of refunding volume. We believe this general trend will continue, although we could see some issuers that believe rates are headed higher come to market before year end.



### Portfolio

We have swapped out of the Sr Cofina zeros and into the Sr Cofina coupons at spreads inside of 50. We believe the zeros have been bid up by non-traditional investors. The Cofina cpns mature 14 years sooner and are more secure.



### *Summary:*

There is no doubt that higher absolute rates, cheap relative valuations, limited supply, improving credits, and higher tax rates have helped to stabilize and improve the market. We like the strategy to add opportunistically.

Thanks for your support and don't hesitate to call.

Talk soon,  
Randy and the rest of the ASA Team.