

MUNIS IMPROVE IN NOVEMBER

The yield curve steepened sharply in November as the 1-30 year spread reached 398 basis points (bp), an increase of 12 bp. The 5 year yield on AAA rated muni's fell 35 basis points to a 1.45 while the 30 year yield for AAA muni's climbed 5 basis points to a 3.85.

Money market funds have lost \$90 billion in assets year to date as investors in need of some return on cash move out on the curve. Ultra short term funds as well as intermediate bond funds have been the largest recipients of this cash flow. Media attention on state and local budget deficits, combined with an uncomfortable feeling about long term inflation, continue to keep investors hesitant to venture too far out on the yield curve. In the 5 year range, yields on AAA municipals are 73% of treasury rates while yields on 30 year AAA municipals are 101% of treasury rates.

The January effect should once again work to keep rates stable. January is a heavy maturity and interest payment month in the municipal bond market. Healthy cash flow from this calendar event, combined with a slowing new issue calendar due to the holidays, should cause a temporary supply/demand imbalance keeping rates low.

feature

DIRT BONDS
TIDBITS

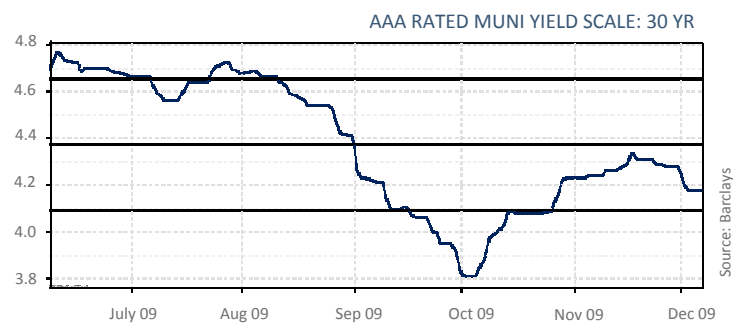
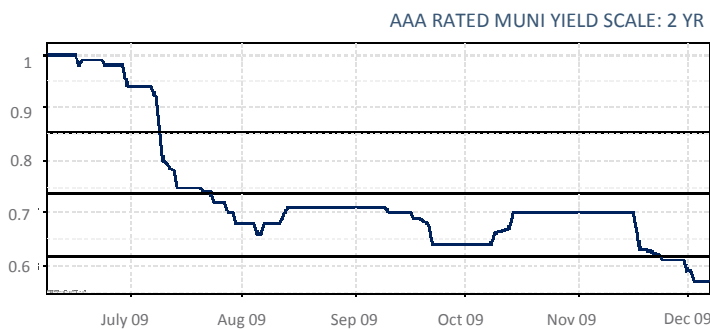


CHART A: AAA RATED MUNI YIELD SCALE VERSUS TREASURY

Year	12/31/2008			10/31/2009			11/30/2009			YTD Change		Month Change	
	MUNI AAA	Treasury	% of Treas.	MUNI AAA	Treasury	% of Treas.	MUNI AAA	Treasury	% of Treas.	MUNI AAA	Treasury	MUNI AAA	Treasury
3 yr	2.03	0.97	209.06%	1.05	1.39	75.54%	0.85	1.10	77.27%	(1.18)	0.13	(0.20)	(0.29)
5 yr	2.47	1.55	159.25%	1.85	2.31	79.98%	1.51	2.00	75.50%	(0.96)	0.45	(0.34)	(0.31)
10 yr	3.52	2.21	158.99%	3.03	3.38	89.64%	2.79	3.20	87.19%	(0.73)	0.99	(0.24)	(0.18)
30 yr	5.04	2.68	188.34%	4.23	4.23	100.00%	4.28	4.19	102.15%	(0.76)	1.51	0.05	(0.04)

THERE IS STILL GOLD IN DIRT BONDS

The burst housing bubble has effected most sectors of the economy. The public sector in general has suffered from falling tax receipts and development driven fees. As such, “Dirt Bonds”, the debt issued by special real estate development districts is particularly vulnerable to fluctuations in the real estate market. Despite their marriage to real estate, there are special district Dirt Bonds that are worth the investment.

WHAT IS A “DIRT BOND” AND WHO ISSUES THEM?

The name derives from that fact that in the case of a default or bankruptcy bondholders could ultimately end up owning the undeveloped real estate “**Dirt**” whose value secures the debt. Dirt Bonds are among the riskier and more volatile municipal bond investments. These bonds are also sometimes referred to as “Land Secured” or “Special District” debt.

Dirt Bonds are issued by special districts formed specifically to fund and build roads, schools, recreational facilities, water, sewer, drainage, and other infrastructures for the benefit of property owners in new real estate developments.

WHERE ARE THE DISTRICTS AND WHY ARE THEY FORMED?

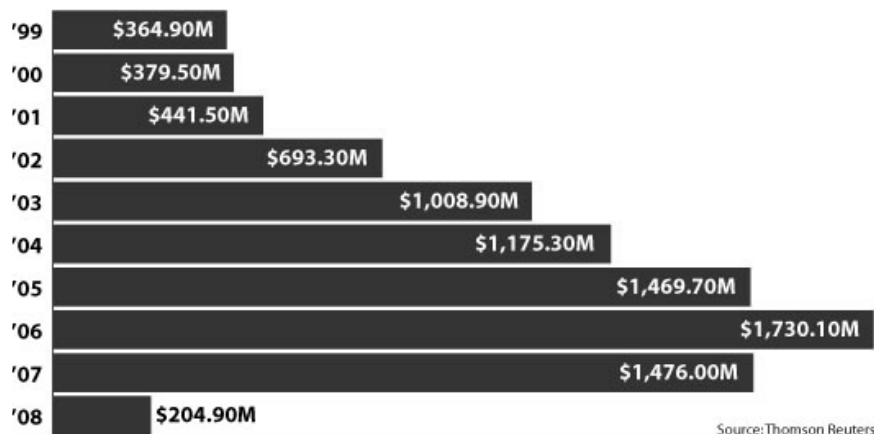
Many States authorize special districts for development. However, large and visible Dirt Bond markets have developed in the hot spots of the real estate crisis; California, Florida, Texas, Colorado, Nevada, and Arizona.

Their formation is driven by local municipal debt limitations as well as political considerations about the equity of burdening residents with the cost of new development. These districts are also formed to provide real estate developers access to tax exempt financing and the means to recover the cost from the district’s residents.

HOW DOES THE PROCESS WORK?

After a district is formed and a development plan is approved by the local government, the district issues debt to fund the construction of roads and utilities. Once the public facilities are constructed, developers can build homes and commercial buildings. Debt repayment derives from annual special assessments and taxes levied on each property in the district. As each property is developed it becomes taxable, increasing and diversifying the tax base.

FLORIDA COMMUNITY DEVELOPMENT DISTRICT ISSUES



This chart represents the issuance of Dirt Bonds in Florida alone.

ARE THESE BONDS MORE RISKY?

Our view is yes. Twenty years of history has produced a 1.5% default rate of all municipal bonds issued. Dirt bonds make up a sizable percentage of that 1.5%. So, yes they can be very risky, especially in this environment. As you are painfully aware, the housing development hot-spots, Florida, California, Arizona, and Nevada have come to a standstill and the bonds issued for the developments are defaulting at a rapid pace. Utilize extreme caution when playing with fire.

The most common problem with Dirt Bonds is failure to develop the district in a timely fashion so that it creates enough taxable property to support the debt service. Development can be impeded by low demand for new homes and commercial real estate, the availability of credit, the quality of amenities, the distance from employment centers, and general economic conditions. The slower the development progresses, the longer bondholders are exposed to the developer, who is under stress and could default on payments. Besides slow development, risk is exacerbated by increased tax payment delinquencies and foreclosures on completed properties due to the housing bubble and mortgage crisis.

ARE THEY WORTH THE RISK?

Different strokes for different folks. Many individuals find the yields offered by these non-rated securities irresistible and usually end up collecting a few positions over the years. We reviewed a portfolio recently that had over 30 different positions in this sector, and yes a few were already in

bankruptcy with several more reaching into their debt reserve funds to make the latest debt payments. This is not a sector that one can buy and never look at again. In-depth knowledge of the area and developer, with special attention to annual financial disclosures are a must if one is to allocate cash to this sector.

THE STAGE FOR SUCCESS

A set of clear rules that govern district formation, development, taxation, and debt issuance is essential. In the best instances, these rules assign appropriate risks to the developer at first and then provide for a transition of risk to the development's new owners. In later stages of development, these rules should tie additional debt needs to corresponding incremental infrastructure needs.

The key factor and indicator of the ability of a special district to repay debt is the progress of development in the district. Bonds outstanding in a district where development is lagging are at risk if debt is escalating faster than the amount of taxable real estate.

WHAT SHOULD I DO IF I OWN DIRT BONDS?

Due to newly passed municipal disclosure rules, current and in-depth information is more accessible than it has ever been for this small sector of the municipal bond market. Annual bond disclosures include: data on units developed, their value, tax delinquencies, foreclosures, debt outstanding, and reserve fund status. Take advantage of sites like www.emma.msrb.org, and stay current on the facts associated with your bonds.

WHAT IS THE GOOD NEWS?

As with most investments, when everybody is dumping it is usually the best time to be buying. Now don't take that as a buy recommendation, let's just say that in every junkyard one can find some exceptional value. Do the homework!

TIDBITS



ASSURED GUARANTY

Assured Guaranty or (AGO) as it is known on the big board, had its credit rating downgraded by Moodys from Aa2 to Aa3. AGO issued a statement expressing its joy for having held on to the Aa rating. The company boasted that even as a worst case scenario its \$12.5 billion claims paying resources are more than sufficient to meet projected obligations. The equity market seems to agree, as several firms have upgraded the stock and raised earnings estimates. JP Morgan raised its price target for the stock from \$28.00 to \$42.00. Assured has been busy writing policies on municipal debt capturing approximately 20% of all new issuance for the month. It helps when you are the only game in town currently.

MBIA

MBIA (MBI) is still struggling with raising capital and fighting lawsuits in connection with the splitting of the insured book between the good side (muni's) and the bad side (mtg's). We personally believe the future is finite for the insurance company. Joseph Brown does not agree however as the CEO of MBIA bought 50,000 shares of the company's common stock which brings his overall holdings to 4.2 million shares. This statement cost him about \$200k and I hope he is right because we would hate to see several thousand more cusips become non-rated when the rating agencies walk away from this company.

BUILD AMERICA BONDS (BAB'S)

Mr. Obama's nominee for the senior Treasury Department position expressed his enthusiasm for the Build America Bond program as he stated "this program is too successful to allow to go away". It is my personal opinion that this program is the beginning of the end of the tax-exempt municipal bond. I have not been able to successfully convince my partners however of this doomsday forecast.

BAB's continue to come to market at a rapid pace, capturing 25% of municipal issuance for the month. We are utilizing the securities in all exempt portfolios. The relative value of BAB's versus corporate bonds and CD's is heavily favored.



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