



## MARKET COMMENTARY

April 2010

### FIRST QUARTER 2010 MARKET REVIEW Flight to Quality Supports Fixed Income

In a sharp flight to quality, the 10-year Treasury yield steadily declined in April to a low of 3.65 percent at month end after almost touching 4.00 percent early in the month. The yield decline came despite stronger economic data, corporate earnings that exceeded expectations and a record amount of Treasury issuance. Investors had much to fear including possible sovereign defaults in Greece and Portugal along with the very real probability of more restrictive banking regulation. The elevation of the Goldman Sachs civil inquiry to a criminal inquiry exacerbated these concerns. Higher rates due to increased Treasury issuance failed to materialize as investors fled to the safety of Treasuries and easily absorbed the supply. Additionally, the Fed again reiterated their intent to keep rates low for an extended period.

### TAX-EXEMPT MARKET REVIEW Munis Perform Well Amidst Low Supply

Tax-exempt bond yields also declined during the month, primarily reflecting low supply. Long maturities in particular performed well due to the lack of long-maturity issuance. Long-maturity issuance came more in the form of Build America Bonds than tax-exempt bonds. The search for yield was again evident in the outperformance of higher yielding, lower quality bonds. A possible additional boost to municipals was the recalibration of ratings by Moody's and Fitch that occurred mid-month. It is difficult to quantify the impact of the recalibrated ratings on market prices. However in certain cases, such as California's, the higher ratings allow investors who were previously restricted from purchasing the bonds to now do so.

### TAXABLE MARKET REVIEW Taxable Municipals Perform Well

Taxable municipal bonds benefited from the flight to quality and outperformed most corporate bond sectors. Long maturities in general performed well as interest rates declined. Bank and broker bonds were

notable underperformers and yield spreads widened significantly in light of the negative events mentioned above. Sovereign credits, even seemingly insulated Canadian provinces, have been affected by the European contagion. We expect to see periodic episodes of a flight to safety to U.S. Treasuries as the European credit crisis lingers.

### IMPLICATIONS FOR THE MUNICIPAL BOND MARKET Yield Curves to Remain Steep Longer than Expected

With the sovereign debt crisis causing much anxiety in global markets, it is important to realize there is little to no similarity between the situation in Greece and the debt situation in U.S. states such as California. As the following table indicates, Greece is clearly in a fiscal crisis situation that is much more extreme than any faced by U.S. states.

GREECE	VS.	CALIFORNIA
\$330 billion GDP (Est)		\$1,850 billion GSP
\$383 billion debt outstanding		\$95 billion debt outstanding
Debt as % of GDP = 116%		Debt as % of GSP = 5%

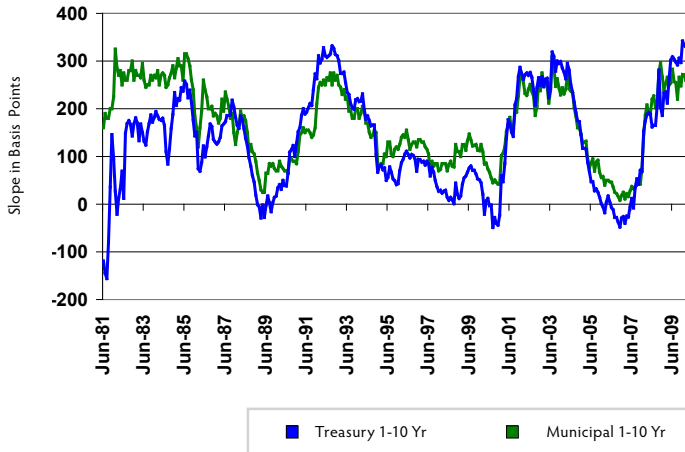
Source: IMF, Bloomberg, BEA, State of California

With fiscal austerity likely to remain a high priority for most of the OECD countries, it is difficult to envision a strong worldwide economic recovery. We expect the Federal Reserve to hold true to its stated intention to keep rates low for an extended period. As a result, we expect the yield curve will remain steep.

## IMPLICATIONS FOR THE MUNICIPAL BOND MARKET, CONT'D

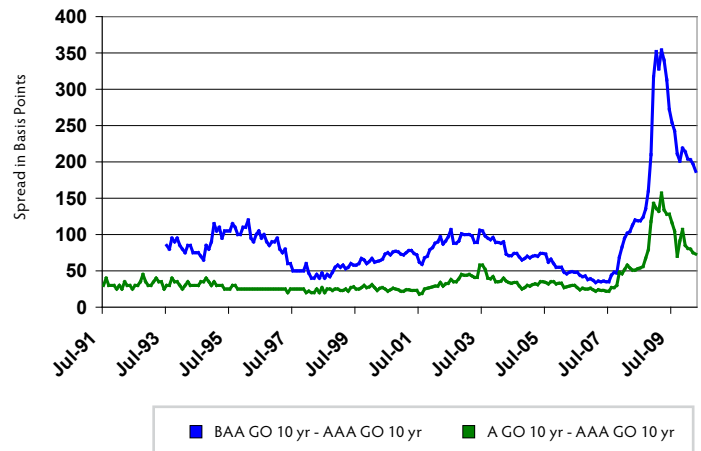
The chart below depicts the yield curve slopes for both the Treasury curve and the municipal curve (1 to 10 years). It is noteworthy that in past periods of economic weakness (1981-83, 1990-92, 2001-04) both yield curves remained steep for a long period of time. We expect this pattern to continue as the current economic recovery slowly unfolds.

### THOMSON REUTERS MUNICIPAL MARKET DATA YIELD CURVE SLOPES



Additionally, we expect the search for yield that has dominated fixed-income markets to continue as rates remain low. From a historical perspective, municipal-bond credit spreads have room to compress further as shown in the chart below. However with Moody's shift to a global rating scale, most A-rated General Obligation and Essential Service Revenue bonds are now in higher rating categories. Consequently, spreads may not regain previous lows.

### THOMSON REUTERS MUNICIPAL MARKET DATA CREDIT SPREADS



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