# Municipal Market

**News, analysis and commentary**

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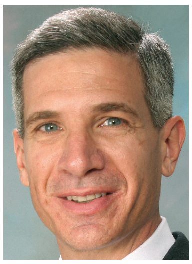
## Q&A SMAs Seeing 'Healthy' Demand Due to Changing Municipal Credit Risks, Waas Says



- Retail investors are increasingly attracted to separately-managed accounts due to more education about credit risks in the municipal market, says Robert Waas, founder and CEO of RSW Investments
- The Summit, New Jersey-based firm, which has over $2 billion in assets under management, focuses investments on bonds that mature in 10 to 15 years because there are less natural buyers

*Waas spoke with Bloomberg Briefs reporter Amanda Albright on March 15. Comments have been edited and condensed for clarity.*

**Q: What makes your investment strategy unique?**

**A:** We're looking for bonds primarily in our market duration strategy. We're looking for bonds that primarily mature between 10 and 15 years and we're really concentrating on bonds that also have above-market coupons and bonds that are callable.

**Q: Why do you use that strategy?**

**A:** If you look back at the past 30 years and you want to see where most of the return in the municipal market comes from, it really comes from yield curve placement. If you're investing in shorter-dated bonds, given that the yield curve has always maintained that upward slope, you want to bypass bonds that mature in, say, one and five years because those yields are so low on a relative basis. If we can concentrate where there are fewer natural buyers — since most individuals are creating ladders between one and 10 years and mutual funds are investing in 25 to 30 year maturities, there are fewer natural buyers in that 10 to 15 maturity range, and that leaves those yields relatively high.

**Q: How have you seen retail investors' habits change?**

**A:** We've been the recipient of that change. In the separately-managed account universe, there's been a shift going from buy and hold, a passive approach, to individuals now working with their financial advisers, partnering with a firm such as ours, and utilizing more of an active strategy. You've seen a very healthy increase in demand in SMAs.

**Q: What accounts for this shift?**

**A:** It's definitely driven by credit and education. Individuals are getting more educated by their financial advisers that this is not your grandfather's municipal bond market. The credit risks are changing in the market place.

**Q: What sort of credits does RSW invest in?**

**A:** Around seven years ago, we started looking way down the road. Our credit standards ratcheted up. We haven't lent money to the state of Illinois in eight years. We never bought a Puerto Rico bond, even when they were single A rated. We believe the clients who come to us have already made their money; they're looking to protect and preserve their wealth. Our credit process is more driven for defense rather than offense.

There are certain sectors we avoid, where we think you're not getting compensated for risk. You're not getting compensated in single-family housing, multi-family housing. You're not getting compensated in health care. If you look at the past 40 years where defaults occur, most are in those sectors. With credit spreads being so tight, you're not getting compensated in those sectors.

**Q: What state or municipality are you seeing warning signs out of?**

**A:** Certainly the state of New Jersey, but that's not new. We all know about the state's tremendous pension obligation issues. What has not crept into the credit spreads yet is that Connecticut and Pennsylvania are heading in the exact same direction. We're extraordinarily cautious in how we approach Pennsylvania and Connecticut. For clients who reside in the state of New Jersey, if they come to us and say, 'We want to be as tax efficient as possible, I want 100 percent of my money in New Jersey,' we'll do it if demanded, but that's not our preference. We alert them to the risk of embarking on a strategy like that and we try to steer them to what we call a preference portfolio, which is 50 percent New Jersey and 50 percent national. We'll make sure the investments in New Jersey are shorter-dated final maturities or call structures. We'll make up that yield differential by investing the second half of the portfolio, nationally, further out on the yield curve.

**Q: What states are you favorable towards?**

**A:** In the low tax states, you've seen a tremendous influx of population — Texas, Florida and Arizona are very strong. In New York, their pensions are, for the most part, fairly well-funded compared to most of the country, and we like the security we're getting with a lot of the issuers. For example, personal income tax bonds are heavily overly collateralized. They're not issuing bonds where the coverage ratio is 1.2 times or something like that — it's many-fold coverage. You can have a tremendous hit to personal income taxes, even the one you saw in 2008, and these securities still, on a relative basis, remained very bulletproof.

## At a Glance

**Residence:** Mountain Lakes, New Jersey

**Education:** B.S. in Accounting at St. John's University

**Career:** Founded RSW Investments, LLC in 2005. He has managed investment grade and high yield open and closed-end mutual funds, pioneered the first portfolio dedicated to municipal bond arbitrage, and launched two SMA strategies and divisions.

**Recommended Book:** Ghost Soldiers by Hampton Sides

**Favorite sports team:** New York Jets

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