Indiscriminate Selling Lowers all Boats (6/21/13)

- There is not an asset class, or a country, that has been spared in this current market re-pricing.

- There is a profound illiquidity in nearly every market, municipals included, with the "riskiest" assets being affected the most.

- There are many potential systemic problems that we have previously written about ("fissures") that the markets are, in our opinion, ignoring.

- As the "risk trade" unwinds, the underlying economic growth problems seem less solved than ever:
    - China's banking and housing bubble
    - Japanese debt problems: expressed as Bank of Japan (BOJ) attempts doubling the size of their QE program
    - European sovereign and banking issues temporarily masked by the European Central Bank (ECB)

- Historically, commodity prices were quite predictive of global economic strength. The recent plunge in commodity prices has been so profound that it shouts: "deflation and/or impending systemic risks".

- With the rate of growth of most world economies already decelerating, these latest stresses could be a game changer for future growth prospects.

- Admitting that every asset class has suddenly re-priced to varying degrees, for us at RSW the first and last question that we need to ask is : Does the world seem more "safe" or less "safe" than it did three or six months ago???

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- As we readily admitted in the past, the municipal bond market can be disproportionally affected by a lack of market liquidity. Akin to other periods of systemic stress (i.e. 2008 and 2010), this time is similar.

- Month to date, municipal bond yields have spiked, putting extreme downward pressure on prices. The performance of the Barclays Capital Municipal Bond Index has fallen by roughly 2.27%.

- Currently, municipal bond funds are experiencing heavy redemptions. In essence, mutual fund portfolio managers are being forced to sell bonds in a "vacuum". In the past, these indiscriminate sales ultimately resulted in setting a bottom for prices. The pattern is a familiar one: The municipal market moves to a level where the new issue calendar contracts markedly as deals get pulled due to higher rates, tax-free bond prices adjust upward to levels whereby the asset class becomes compelling to those investors who do not necessarily need tax free income (relative value investors), and longer term investors seek the relative safety and higher yields afforded by the municipal bond market. It appears that we are in the early stages of this cycle.

- We will continue to closely monitor this downturn, with an eye toward taking advantage of future opportunities that may present themselves in the wake of the downturn in market liquidity and issuance. Ultimately, we continue to believe that any sustained rise in rates will only serve to put further downward pressure on economic activity, resulting in flight-to-quality moves that would advance the cause of US Treasury and other fixed-income asset classes.

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