



Meredith Whitney's "Tragedy of the Commons": RSW's Synopsis – 10/5/2010

- As we have often said, the headlines are typically cataclysmic, while the body of the articles typically provides more balanced presentations. Here again, the same applies with respect to Whitney's analysis and conclusions.
- We have reviewed an abridged version of the aforementioned report. Whitney does an excellent job of addressing the issues confronting the state of the states. However, it does not break any new ground.
- Nor does it shed any new light regarding issues and concerns that RSW Investments may have concerning specific states and credits.
- One of the report's "Key Points" states... **"Debt service at the states level is not something that we believe is at risk,** however, we do believe heavily strained state finances will make state transfers to local governments much more difficult."
- *In short, we concur, but with that said, we do not have a cavalier approach towards investment in state credits. We are fully cognizant of the shifting values associated with the different state credits. And we fully recognize that there has been a sea change in public finance, whereas we continue to find no value in weak states such as California and Illinois.*
- The report states the following: "We believe that at some point over the next twelve months, budget gaps will become so large that states will be forced to either take very tough austerity measures through program cuts and government job cuts, withstanding the use of federal stimulus funds, there is approximately \$144 billion



cuts or the federal government will have to introduce its third near trillion dollar bailout.”

- We do not believe that there will be another trillion dollar bailout dedicated to the states. In fact, with the adoption of the fiscal 2011 budgets that the states are confronted with, notwithstanding the use of federal stimulus funds, there is approximately \$144 billion in budget shortfalls. This is in addition to the \$200 billion of shortfalls confronted in 2009 and 2010. As a result, the states have responded with a combination of various revenue enhancements and budget cut-backs. Specifically, the states sliced their budgets by 4% in fiscal 2009 and 6.8% in fiscal 2010. As a result, the states have closed shortfalls of more than \$500 billion since the start of the recession.
- We believe if the federal government does continue the stimulus program; it will be earmarked for specific purposes and targeted to the continuation of state funding for the respective programs. It will not take the form of case by case individual state bailouts as that would be politically unpalatable.

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