The Municipal Bond Rally Stalls **(12/18/12)**

Municipal bond yields declined precipitously from the start of the second quarter 2012 through the first week in December, with little interruption. The strength of the rally was supported by strong money flows (including $53 billion into long municipal bond funds), and declining Treasury bond yields.

- Over the past week, the upward price momentum stalled abruptly, and yields quickly reversed course.
- In RSW's opinion, the municipal market "got ahead of itself", as yields declined to generational lows.
- We are, therefore, not surprised that the market is experiencing a correction, as one has been long overdue.
- Accordingly, as stated in RSW's 2013 Investment Outlook, we have adopted a more defensive strategy, and will shift this stance only when we believe investors are more adequately compensated for risk.

Although "retail investors" are still allocating funds to the municipal market, "professional managers" had been reluctant to deploy new monies at peak price levels, and are, therefore, continuing to allow their cash positions to accumulate amidst growing uncertainty.

Such Uncertainty Reflects:

- The "Fiscal Cliff".
- Potential caps on tax-exempt income.
- Potential changes in marginal tax rates.
- Heavy 2012 year-end new issuance.
- Moody's recent 2-notch downgrade of Puerto Rico municipal bonds to minimal investment grade (some credits below investment grade), while maintaining a negative outlook.
- Illinois pension woes, and various California municipal bankruptcy filings.

Our Thoughts Are As Follows:

As stated, we have adopted a more defensive posture in our client portfolios. We are not surprised by the very recent under-performance of the municipal market relative to U.S. Treasury bonds -- from the lofty levels recently attained. While the timing of the "correction" has been relatively rapid, the shift to a more "balanced" municipal/treasury ratio relationship was, in our opinion, inevitable. Given today's continued market sell-off (December 18, 2012), the price (rise in yield) declines experienced to date have largely erased the outsized gains realized during the month of November.

Keep in mind that new issue volume comes to a virtual halt during the Holiday Season through the first half of January. This tradition, combined with the significantly large seasonal capital infusion from January 1st coupon payments, bond maturities, and redemptions has historically acted to bolster municipal bond price levels during this period. We suspect that such technical considerations should again provide support to the municipal market as we enter the first months of 2013.

Robert S. Waas **Managing Member**	**Robert K. Coates** **Senior Portfolio Manager**	**Matthew T. Werner** **Portfolio Manager**	**Mark J. Tenenhaus** **Director of Municipal Research**	**John A. Carlson** **Director of Business Development**	**Marites A. Vidal** **Data Analyst**	**Randy J. Fox** **Operations Associate**	**Brian E. Pawl** **Operations Associate**	**Irina Brooklier** **Client Service Assistant**

This document was prepared on 12/18/12 and is not intended to be a solicitation of Firm interests. Past Performance does not guarantee future results. Investments are subject to risk and may lose value. The information is not warranted as to completeness or accuracy, nor does it serve as an official record of your account. RSW Investments does not render legal, accounting, or tax advice. Please consult your tax or legal advisors before taking any action that may have tax consequences.

This report has been prepared by, and reflects the views as of this date of, RSW Investments, LLC [RSW hereafter]. RSW's views and opinions are subject to change. Investors should consult their attorney, accountant, and/or tax professional for advice concerning their particular situation.

All views expressed in the research report accurately reflect the Managing Member's personal views about any and all of the subject topics. No part of the Managing Member's compensation was, is, or will be directly or indirectly related to the specific recommendations or views expressed by the Managing Member in the research report.