



## RSW's Take on Municipal Disclosure Revisited

In the business section of Sunday's New York Times appeared an article dealing with inadequate Municipal issuer disclosure entitled "Red Flags that Muni Investors Can't see." This was almost an identical article published by the same author Gretchen Morgenson on August 31, 2008. Using data compiled by DPC (one of four municipal financial information repositories), the New York Times article outlines the "spotty" nature by which municipal debt issuers released their annual financial statements and material changes in their financial position.

As in all boom times, standards become relaxed as issuers, investment banks, and investors, pay less attention to the timeliness of financial disclosure. The Municipal bond Insurer's (AMBAC, FGIC, and MBIA) are certainly a testament to this phenomenon. To my way of thinking, municipal issuers can do more to tighten the way that they report their financial results. In fact, the SEC is taking a lead role as they are considering changes in the way that issuers release financial information. Currently, borrowers must disclose material events, bond calls, adverse tax opinions, and financial results with four Nationally Recognized Municipal Securities Information Repositories (NRMSIRs). To streamline the process the SEC is proposing to have one central depository for the information, called EMMA (Electronic Municipal Market Access). As an aside, if this new mandate is approved the need for the four NRMSIRS is obviated, and yes that includes DPC, mentioned above. The topic is a good one. We agree that the degree, timing, and manner by which some municipal issuers report is sorely lacking, particularly when compared to their taxable brethren.

Without seeking to minimize the issues, it has been my experience that over the last couple of decades the municipal bond market is virtually "two-tiered". The financial reporting for smaller, lower-rated issuers may be woefully inadequate while the financial disclosure for "larger revenue bonds and state obligation debt, was less alarming than DPC Data's study". No question, this market needs and deserves better disclosure. For well over a year RSW has taken the position that our financial system will remain under considerable stress. By seeking to acquire the "best credits" available in each state we are in essence building in a cushion to deteriorating financials, higher than average downgrades, and yes even reporting that is more lax than we would like.

Sincerely,  
Robert S. Waas  
Managing Member

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## A Tale of Two Curves

3/4/2009

Why are tax-exempt yields rising? And what maturity segments are most under pressure?

Since municipal bond yields reached their lows in mid-February, we have witnessed a rather persistent rise in rates. However, this increase in rates has not been a parallel rate shift across the yield curve. Rather, individual maturity ranges have behaved quite differently, as investors have become more sanguine about their outlook on credit risk and inflation. Specifically, market participants have opted to either exchange shorter-maturity bonds for longer-maturity securities or have sought to deploy new funds farther “out the yield curve”. This tactic has caused the investment results of varying maturity sectors to behave quite differently. The dichotomy of performance can best be illustrated by reviewing total rate of return statistics of the Barclays (formerly Lehman) Municipal Bond Index. For example, year-to-date through February 13<sup>th</sup> the 7-year part of the index posted a negative 209 basis point return (-2.09%) compared to a negative 83 basis points (-0.83%) for bonds maturing in the 20 year sector. It is a bit counterintuitive that bonds which are more interest rate sensitive (longer maturity) have declined less in price compared to shorter maturity bonds.

In general, many investors seem to be rather apathetic about deploying new monies at this juncture. To put the ratio of supply to demand into perspective let us remember that yields had already dropped dramatically from crisis induced highs between mid December 2008 and mid February 2009 (roughly 125 basis points). That rush to buy bonds and their related low yields are now causing investors to balk at the low absolute level of interest rates. For the last couple of weeks, we have witnessed a “buyers strike” where rates are in the process of reverting back to a level that brings in new capital. This process now seems to be fairly well advanced and possibly in it’s latter stages.

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