# 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 13th 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.

Sincerely,

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Managing Member



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