

MUNICIPAL BOND MARKET NOTE

JANNEY FIXED INCOME STRATEGY

January 12, 2012



Investors should not be overly concerned with reports of FY2013 state budget shortfalls.

States possess the sovereign ability to solve shortfalls with levers such as reductions in public sector spending and/or tax increases. Forty six states have reduced services and 30 states have increased taxes recently according to data from the Center on Budget and Policy Priorities.

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State Fiscal Health Scorecard - Jan 2012

- U.S. states are projecting their lowest budget shortfalls of the Great Recession cycle. Improvement reflects higher taxes, lower spending, and a gradual but widespread economic recovery.
- States posted a 7th consecutive quarter of higher revenue in 3Q2011 – 7.30% higher.
- The housing market is bottoming according to MBA delinquency and foreclosure data. Both metrics are trending lower from 2009 and 2010 highs.
- Dec 11 unemployment declined to 8.50%- dropped below 9.00% for the first time since 1Q09.
- Average state credit spreads are almost 10 basis points lower versus a year ago. This indicates an improving credit environment for U.S. states, one which is likely to slowly continue.

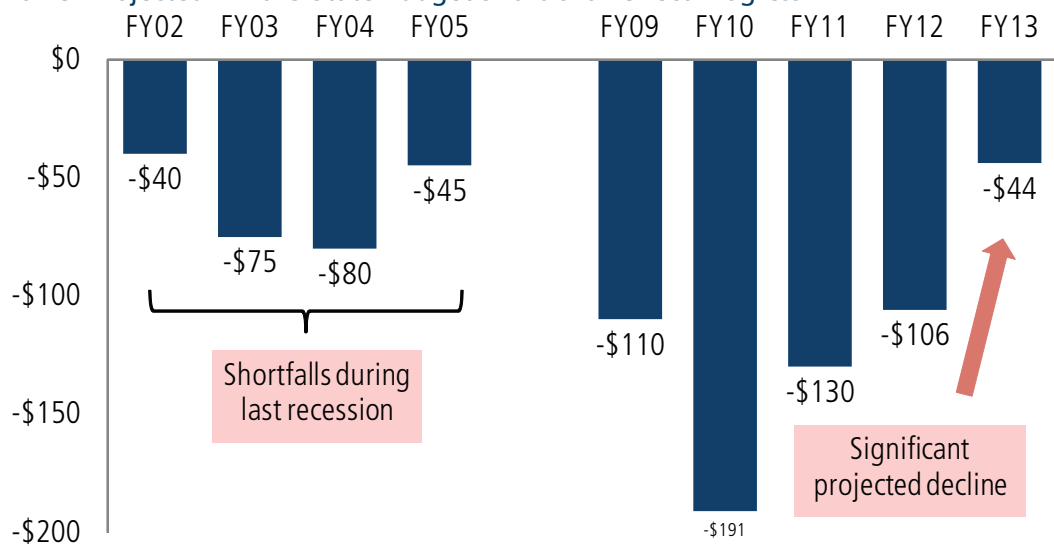
State Budget Shortfalls are the Lowest of the Great Recession Period

It was about this time last year when various market observers irrationally worried about state bankruptcies. Market sentiment was so dire that we titled our Jan. 2011 State Health report, "States' Ability and Willingness to Pay Debt Service Remains Strong." What a difference a year makes. We have continually advised investors that the time for the greatest concern was middle to late 2010 when the economy was still searching for its bottom. Economic indicators have almost all trended positive since then. The latest state budget shortfall data, which is a significant improvement at a 5 year low of \$-44 billion, is partly a reflection of improving indicators.

Budget Shortfalls are Not Deficits

State budget shortfalls (or gaps) refer to a situation when the difference between expenditures (usually based on the last fiscal year) and projected revenues is negative. Shortfalls are certainly curable and in FY2012 states eliminated \$106 billion with mostly credit-friendly solutions. Shortfalls in

Lower Projected FY2013 State Budget Shortfalls Reflect Progress



Source: Center on Budget and Policy Priorities (Jan 9, 2012) and Janney FIS. (\$ in billions)

state budgets should be distinguished from budget deficits. A deficit is a loaded concept because it implies that that state governments, like the federal government, sells debt to finance spending and that is not true for U.S. states. In addition, all states have balanced budget requirements (except for Vermont) and although 29 states are projecting shortfalls for FY13, they will all close them by utilizing one or more of their available levers.

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Janney State Fiscal Health Scorecard

State	Bond Ratings (*denotes a lease or ICR)	Spread to 10Y MMD Jan 9, 12	Spread to 10Y MMD Jan 4, 11	FY13 Projected Budget Gaps % of FY12 Budget	Prelim 3Q11 % Change in Tax Collections	Per Capita Real GDP by State Dec 2010	"Seriously Delinquent" Morts. 3Q11	Unemploy. Rate Nov 11
Total/Average		24	32	11.8%	7.3%	\$37,797	7.9%	8.7%
Alabama	Aa1AA/AA+	32	30	None	3.5%	\$32,245	5.5%	8.7%
Alaska	Aaa/AAA/AA+	20	25	None	25.0%	\$63,424	2.3%	7.3%
Arizona*	Aa3/AA-/NR	32	38	None	18.9%	\$35,745	7.5%	8.7%
Arkansas	Aa1/AA/NR	21	30	None	2.5%	\$31,492	5.2%	8.0%
California	A1/A-/A-	75	125	9.8%	0.2%	\$46,488	7.7%	11.3%
Colorado*	Aa1/AA/NR	22	30	8.4%	5.7%	\$46,757	4.2%	8.0%
Connecticut	Aa2/AA/AA	20	21	14.4%	10.5%	\$59,132	7.9%	8.4%
Delaware	Aaa/AAA/AAA	2	0	None	-13.8%	\$62,587	7.1%	7.6%
Florida	Aa1/AAA/AAA	30	38	8.4%	3.9%	\$35,815	18.9%	10.0%
Georgia	Aaa/AAA/AAA	0	2	None	7.2%	\$37,366	7.7%	9.9%
Hawaii	Aa2/AA/AA	24	27	8.9%	No Data	\$43,615	7.3%	6.5%
Idaho*	Aa1/AA+/AA-	25	30	None	4.6%	\$32,344	5.3%	8.5%
Illinois	A2/A+/A	160	210	None	38.8%	\$45,302	11.0%	10.0%
Indiana*	Aaa/AAA/AA+	22	30	None	10.2%	\$37,855	8.3%	9.0%
Iowa*	Aaa/AAA/AA+	20	23	None	-3.5%	\$41,908	4.8%	5.7%
Kansas*	Aa1/AA+/NR	25	35	None	7.3%	\$39,964	4.8%	6.5%
Kentucky*	Aa2/AA-/AA-	25	28	Yes, Unknown	5.3%	\$33,326	6.8%	9.4%
Louisiana	Aa2/AA/AA	26	33	Yes, Unknown	4.3%	\$43,052	6.8%	6.9%
Maine	Aa2/AA/AA+	15	25	15.5%	4.0%	\$34,592	8.6%	7.0%
Maryland	Aaa/AAA/AAA	0	0	6.9%	4.1%	\$45,878	8.5%	6.9%
Massachusetts	Aa1/AA+/AA+	19	28	Yes, Unknown	6.5%	\$34,592	6.7%	7.0%
Michigan	Aa2/AA-/AA-	50	80	None	5.4%	\$34,893	7.3%	9.8%
Minnesota	Aa1/AA+/AA+	4	3	11.6%	No Data	\$45,891	4.6%	5.9%
Mississippi	Aa2/AA/AA+	25	32	Yes, Unknown	3.8%	\$29,345	8.0%	10.5%
Missouri	Aaa/AAA/AAA	0	0	10.0%	0.0%	\$36,287	4.9%	8.2%
Montana	Aa1/AA/AA+	23	25	Yes, Unknown	14.3%	\$52,251	3.3%	7.1%
Nebraska*	Aa2/AAA/NR	23	40	10.0%	4.6%	\$43,625	3.2%	4.1%
Nevada	Aa2/AA/AA+	75	80	37.0%	4.9%	\$41,321	13.9%	13.0%
New Hampshire	Aa1/AA/AA+	3	16	20.0%	3.0%	\$41,464	5.0%	5.2%
New Jersey	Aa3/AA-/AA-	34	54	None	No Data	\$49,901	11.9%	9.1%
New Mexico	Aaa/AA+/NR	14	24	None	No Data	\$35,355	6.0%	6.5%
New York	Aa2/AA/AA	20	31	3.5%	4.6%	\$53,377	9.3%	8.0%
North Carolina	Aaa/AAA/AAA	0	1	10.2%	17.1%	\$39,917	6.1%	10.0%
North Dakota*	Aa1/AA+/NR	25	30	None	25.0%	\$46,468	1.9%	3.4%
Ohio	Aa1/AA+/AA+	30	32	10.8%	9.7%	\$36,936	8.6%	8.5%
Oklahoma	Aa2/AA+/AA+	28	28	None	8.9%	\$35,578	5.7%	6.1%
Oregon	Aa1/AA+/AA+	13	24	24.0%	10.4%	\$43,519	6.1%	9.1%
Pennsylvania	Aa1/AA/AA+	20	17	2.7%	3.5%	\$39,830	6.5%	7.9%
Rhode Island	Aa2/AA/AA	48	50	4.6%	2.1%	\$41,816	7.9%	10.5%
South Carolina	Aaa/AA+/AAA	1	2	None	4.7%	\$31,378	7.4%	9.9%
South Dakota*	Aa2/AA+/AA	28	40	None	18.9%	\$44,550	2.7%	4.3%
Tennessee	Aaa/AA+/AAA	2	4	None	4.0%	\$36,040	6.3%	9.1%
Texas	Aaa/AA+/AAA	18	26	20.4%	13.1%	\$43,993	4.7%	8.1%
Utah	Aaa/AAA/AAA	0	2	None	2.3%	\$37,194	5.5%	6.4%
Vermont	Aaa/AA+/AAA	10	18	6.1%	4.2%	\$36,981	5.0%	5.3%
Virginia	Aaa/AAA/AAA	0	0	0.9%	6.4%	\$47,570	4.2%	6.2%
Washington	Aa1/AA+/AA+	24	24	22.2%	5.5%	\$45,599	6.5%	8.7%
West Virginia	Aa1/AA/AA+	33	35	4.9%	3.2%	\$30,217	4.8%	7.9%
Wisconsin	Aa2/AA/AA	23	30	11.3%	5.0%	\$38,912	5.9%	7.3%
Wyoming*	NR/AAA/NR	22	30	None	9.6%	\$61,049	2.4%	5.8%

Sources: MMD spreads per Thomson Reuters; Budget shortfalls/gaps from Center on Budget and Policy Priorities- Jan 9, 2012; Change in state tax revenues from Rockefeller Institute- Dec 8, 2011, revs for AK (124%) and ND (157%); Per capita real GDP from World Bank and Bureau of Economic Analysis- Dec 30, 2010; "Seriously delinquent" refers mortgages in foreclosure & those 90 days past due data (non-SA) from the Mortgage Bankers Association 3Q2011. Unemployment rate (SA) per Bureau of Labor Statistics as of Nov 2011 (state data for Dec not yet available); and Janney FIS.

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