

MUNICIPAL BOND MARKET NOTE

JANNEY FIXED INCOME STRATEGY

October 27, 2011



Investors should be pleased considering the unprecedented questions about state government credit quality expressed recently. Remember, some even speculated at the beginning of 2011 about the need for states to have the ability to file for bankruptcy.

Spending pressures from growing pension liabilities, questions about Medicaid expenditures and uncertainty surrounding future federal deficit reduction, while manageable in the short term, could build over time.

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State Fiscal Health Scorecard Update - Oct 2011

- U.S. states showed they were willing and able to pay debt service in 2011, and we expect the same fulfillment of debt service obligations going forward.
- Recent activity and data demonstrate that states are not overleveraged in the same manner as the worst European sovereigns and provide further evidence that Meredith Whitney's comments, throughout 2010 and 2011, were overstated.
- Many states resolved FY2012 budget shortfalls, as expected, with credit-friendly solutions such as tax increases and spending cuts.
- While they appear to have reached a plateau, state credit profiles could worsen if future action is not taken to battle structural budget gaps. One time fixes, short-term budget solutions, and expectations to "grow out" of fiscal deficits are misguided approaches.

States Exercised Their Sovereign Ability to Raise Revenues and Decrease Spending

Many U.S. states increased taxes, some cut spending, and others used a combination of both strategies in order to balance over \$100 billion of FY2012 budget shortfalls. This is consistent with our statements throughout 2011 advising investors that state governments are masters of their own destinies, have the sovereign ability to adjust to the current economic environment when needed, and would likely have to resort to tax hikes and spending cuts in order to balance their budgets. Several factors have been trending in a favorable direction for states. State tax revenues have been higher for six straight quarters (positive in July & August too) and questions about unsustainable expenditures are being addressed in some states. Overall, municipal investors should be pleased, but not all that surprised, to find most State government credits have stabilized after the Great Recession.

Credit spreads have generally reflected states' fiscal adjustments, most of which were of the credit friendly variety, and helped them narrow through 2011. California and Rhode Island's spreads widened, in contrast, as a result of other factors as indicated in the below table.

Many Market Spreads Reflect States' Willingness to Make Budget Adjustments

State	Spread to 10Y MMD (basis points)			Notes
	Jan 4, 2011	Aug 11, 2011	Oct 24, 2011	
Lower Spread Relative to Beginning of 2011				
Illinois	210	140	169	Raised taxes, bills and pensions still an issue
Michigan	80	73	63	Cut \$1.6 bill spending (1/3 school funding)
Nevada	80	60	60	Reduced spending and enacted temporary taxes
New Jersey	54	80	53	Summer pension reform is a plus, \$1 billion in cuts
New York	31	24	27	Closed \$10 bill shortfall w/ cuts, on-time budget
Texas	26	13	13	Reduced spending but structural issues remain
Similar Spread Relative to Beginning of 2011				
California	125	80	127	Underperform. of tax revenues, cuts may be needed
Higher Spread Relative to Beginning of 2011				
Rhode Island	50	45	60	Pension liabilities loomed but might be reversed

Source: Thomson Reuters and Janney FIS.

U.S. State Governments' Fiscal Path at a Crossroads

Several obstacles still exist for states to overcome in order for their credit profiles to return to medium and long term fiscal stability. We expect many of the potential solutions will need to be political in nature in order to become sustainable and result in long-lasting positive credit effects.

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Janney State Fiscal Health Scorecard

State	Bond Ratings	Spread to 10Y MMD Jan 4, 11	Spread to 10Y MMD Oct 24, 11	Prelim 2Q11 % Change in Tax Collections	Tax Supported Debt as % of State GDP	Funded % of State Pension Program	"Seriously Delinquent" Morts. 2Q11	Unemploy. Rate (Sept)
Total/Average		32	27	11.4%	4.48%	78%	7.9%	9.1%
Alabama	Aa1/AA/AA+	30	28	8.4%	4.76%	74%	5.5%	9.8%
Alaska	Aaa/AA+/AA+	25	20	99.0%	8.88%	61%	2.2%	7.6%
Arizona	Aa3/AA-/NR	38	32	15.1%	1.96%	78%	8.6%	9.1%
Arkansas	Aa1/AA/NR	30	21	9.8%	3.95%	78%	4.9%	8.3%
California	A1/A-/A-	125	127	7.2%	5.08%	81%	8.1%	11.9%
Colorado	NR/AA/NR	30	22	10.1%	4.03%	69%	4.2%	8.3%
Connecticut	Aa2/AA/AA	21	22	14.4%	10.80%	62%	7.7%	8.9%
Delaware	Aaa/AAA/AAA	0	0	15.8%	6.35%	94%	7.0%	8.1%
Florida	Aa1/AAA/AAA	38	35	0.6%	3.93%	84%	18.7%	10.6%
Georgia	Aaa/AAA/AAA	2	0	3.0%	2.79%	87%	7.7%	10.3%
Hawaii	Aa2/AA/AA	27	27	No Data	10.30%	69%	0.0%	6.4%
Idaho	Aa1/AA+/AA-	30	25	7.9%	3.03%	74%	5.6%	9.0%
Illinois	A1/A+/A	210	169	37.7%	3.97%	51%	10.6%	10.0%
Indiana	Aaa/AAA/AA+	30	26	9.3%	1.92%	67%	8.2%	8.9%
Iowa	Aaa/AAA/AAA	23	20	8.5%	2.24%	81%	4.6%	6.0%
Kansas	Aa1/AA+/NR	35	25	18.7%	2.78%	64%	4.6%	6.7%
Kentucky	Aa2/AA-/AA-	28	28	9.6%	4.64%	58%	6.6%	9.7%
Louisiana	Aa2/AA/AA	33	30	18.2%	3.77%	60%	6.8%	6.9%
Maine	Aa2/AA/AA+	25	14	4.6%	10.14%	73%	8.4%	7.5%
Maryland	Aaa/AAA/AAA	0	0	1.1%	3.20%	65%	8.2%	7.4%
Massachusetts	Aa1/AA+/AA+	28	22	14.7%	8.65%	68%	6.6%	7.3%
Michigan	Aa2/AA-/AA-	80	63	11.7%	6.03%	79%	7.3%	11.1%
Minnesota	Aa1/AA+/AA+	3	8	No Data	6.87%	77%	4.7%	6.9%
Mississippi	Aa2/AA/AA+	32	33	3.6%	4.55%	67%	7.8%	10.6%
Missouri	Aaa/AAA/AAA	0	0	1.3%	1.98%	79%	4.7%	8.7%
Montana	Aa1/AA/AA+	25	23	4.0%	1.55%	74%	3.3%	7.7%
Nebraska	Aa2/AA+/NR	40	25	21.1%	0.05%	88%	3.2%	4.2%
Nevada	Aa2/AA/AA+	80	60	No Data	2.44%	72%	14.3%	13.4%
New Hampshire	Aa1/AA/AA+	16	3	-10.0%	3.75%	58%	4.9%	5.4%
New Jersey	Aa3/AA-/AA-	54	53	No Data	7.81%	66%	11.4%	9.2%
New Mexico	Aaa/AA+/NR	24	18	7.5%	5.37%	76%	5.9%	6.6%
New York	Aa2/AA/AA	31	27	21.1%	5.61%	101%	9.0%	8.0%
North Carolina	Aaa/AAA/AAA	1	0	18.7%	1.80%	97%	5.9%	10.5%
North Dakota	Aa1/AA+/NR	30	25	56.1%	4.26%	81%	1.8%	3.5%
Ohio	Aa1/AA+/AA+	32	34	11.0%	3.44%	66%	8.5%	9.1%
Oklahoma	Aa2/AA+/AA+	28	28	15.9%	1.38%	57%	5.6%	5.9%
Oregon	Aa1/AA+/AA+	24	12	12.7%	9.28%	86%	6.1%	9.6%
Pennsylvania	Aa1/AA/AA+	17	20	9.1%	3.11%	81%	6.2%	8.3%
Rhode Island	Aa2/AA/AA	50	60	6.0%	7.09%	59%	8.0%	10.5%
South Carolina	Aaa/AA+/AAA	2	1	6.6%	2.75%	69%	7.1%	11.0%
South Dakota	A1/AA+/AA	40	30	12.6%	1.30%	92%	2.8%	1.6%
Tennessee	Aaa/AA+/AAA	4	3	3.3%	2.26%	90%	6.3%	9.8%
Texas	Aaa/AA+/AAA	26	13	9.7%	1.66%	84%	4.5%	8.5%
Utah	Aaa/AAA/AAA	2	1	13.0%	6.86%	86%	5.5%	7.4%
Vermont	Aaa/AA+/AAA	18	10	6.0%	5.32%	73%	5.1%	5.8%
Virginia	Aaa/AAA/AAA	0	0	7.1%	2.70%	80%	4.2%	6.5%
Washington	Aa1/AA+/AA+	24	29	13.4%	6.82%	99%	6.4%	9.1%
West Virginia	Aa1/AA/AA+	35	33	1.2%	6.15%	56%	4.6%	8.2%
Wisconsin	Aa2/AA/AA	30	27	5.1%	4.60%	100%	5.9%	7.8%
Wyoming	NR/AAA/NR	30	23	5.5%	0.11%	89%	2.7%	5.8%

Source: Janney Montgomery Scott FIS and below. MMD spreads are per Thomson Reuters. % Change in Tax Revenue is preliminary data for the period 2Q2010 to 2Q2011 and from Rockefeller Institute Sept 2011. NTSD to state GDP is per Moody's May 2011 State Debt Medians Report. State pension data from Pew 2011 report (data from 2009). A plan 80% funded is considered healthy by the GAO. Mortgage foreclosure & 90 days past due data (non-SA) from the Mortgage Bankers Association 2Q 2011. Unemployment rate (SA) per the Bureau of Labor Statistics as of September 2011.

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