

# TAXABLE MUNIS ATTRACTIVE ON RELATIVE VALUE BASIS

## JANNEY FIXED INCOME STRATEGY

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Spreads for taxable munis are above levels of recent years, creating investor opportunity.

The amount of outstanding taxable munis offers enough critical mass to justify a strong following from investors.

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### TAXABLE MUNIS REVISITED

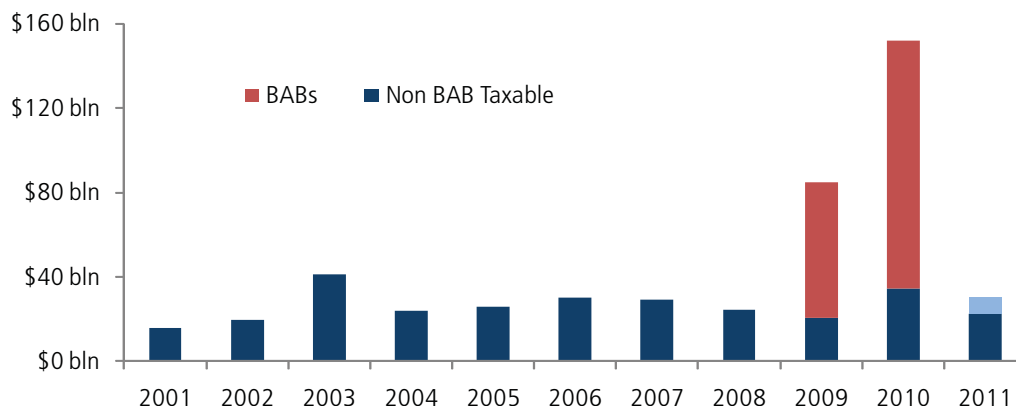
- The advent of BABs identified a new class of investor for municipal bonds.
- Not all taxable municipal bonds are BABs, with pension funding issues adding to totals.
- Elevated spreads offer an opportunity for tax advantaged accounts such as IRAs.

Taxable munis have been around for many years, but until recently they were treated as outliers in the municipal market, with little regular following and statistical information. This changed when the 2009 stimulus bill, known as ARRA, opened a 21 month window for the issuance of taxable Build America Bonds or BABs. By forgoing the lower interest costs of tax exempt bonds, municipal bond issuers were able to receive a federal payment equal to 35% of interest cost, which in most cases generated lower net interest expense for states, cities, towns and other municipal borrowers. The total of \$180 billion in BABs issuance, including \$117 billion last year, led to 2010's record municipal volume of \$433 billion.

Prior to BABs, taxable municipal issues were used primarily to fund state and local pension plans, although bonds were issued for a variety of other purposes that did not qualify for tax exemption. The jump in 2003 taxable issuance, for example, was attributable to a slowing economy producing flat or declining tax revenues for many state and local governments. Rather than fund pensions from current revenues, many chose to contribute to pension plans using borrowed funds. Perennial borrower Illinois floated the largest long term municipal loan in history, issuing \$10 billion of pension funding bonds in June 2003. The state continues to set records, owning bragging rights for the largest municipal issue of 2011, a \$3.7 billion taxable pension funding loan, which sold in February.

Despite heavy lobbying by state and local government representatives, Congress declined to extend the BABs program beyond its December 2010 sunset. The legacy of BABs continues, with the amount of outstanding taxable municipal issues standing above \$300 billion, about triple pre-2009 levels. Although not comparable in size to the \$3 trillion muni market or \$8 trillion corporate bond market, the amount of outstanding taxable munis offers enough critical mass to justify a strong following from investors. The advent of BABs created a new class of investor for municipal bonds, with demand coming from pension funds, non US institutions and other entities which did not previously consider municipals since they had

### Two Years of BABs Issuance Broadened Market for Taxable Municipal Bonds

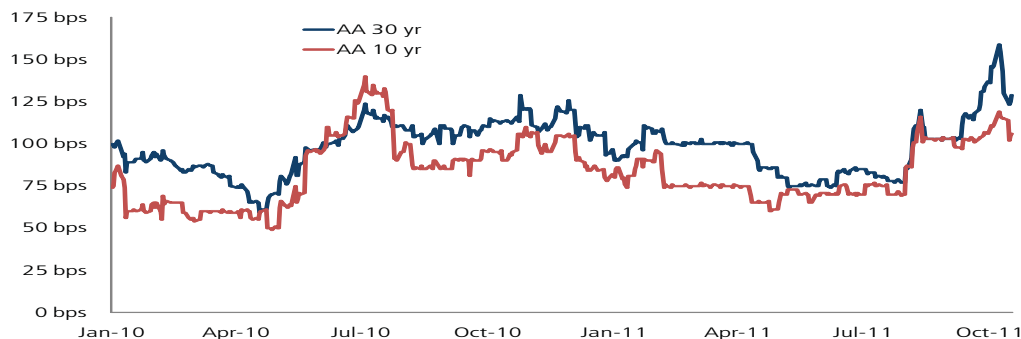


Source: Thomson Reuters Bond Buyer, Janney Fixed Income Strategy

little need for tax exempt income.

We look regularly at municipal to Treasury ratios as an indicator of relative value for tax free bonds. Followers of taxable munis, however, consider spread to Treasuries, the yield differential between a taxable bond or index and that of a like maturity US Government security, as a measure of relative value for taxable issues. Beginning in September, spreads for taxable munis began to widen, with spreads on 10 year AA rated maturities peaking at 119 basis points while those of 30 year maturities hit 159 basis points. Although spreads receded in recent days, they still remain well above levels of the past year, and offer an attractive option for investors seeking taxable fixed income investments.

**Spreads of Taxable Munis are Elevated**



Source: Thomson Reuters MMD, Janney FIS

Spreads on 10 year AA rated maturities peaked at 119 basis points while those of 30 year maturities hit 159 basis points.

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