

NEW JERSEY DEBT OVERVIEW

JANNEY FIXED INCOME RESEARCH

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New Jersey bonds range from AAA issues which finance clean drinking water to high yield tobacco settlement revenue bonds.

GENERAL OBLIGATION

AA3/AA-/AA

APPROPRIATION BACKED

A1/A+/AA-

TURNPIKE REVENUE

A3/A+/A

SINGLE FAMILY HOUSING PROGRAM

2003 RES - AA2/AA/NR

2009 RES - AA1/AA/NR

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SUMMARY

- New Jersey is a wealthy state by most measures, but has lagged the national economy in recovery since the Great Recession.
- High levels of debt and pension liabilities are contributing factors to recent rating downgrades.
- Since May, trading spreads on GO bonds have narrowed significantly, with yields on recent trades running about 50 basis points above benchmark AAa yields.
- Although a double dip recession could set the state's recovery back, we believe the financial trend for New Jersey is positive.

INTRODUCTION

With two rating downgrades this year, and a high profile governor determined to cut spending with no tax increases, New Jersey has been front and center in media and investor attention. The state tops most in wealth metrics such as per capita income, but its tax revenue generation has been significantly impacted by the Great Recession, after many years of growth in both spending and liabilities, including pension and other employee related obligations (OPEB). This year, Moody's and S&P both downgraded their ratings for the state and Fitch assigned a negative outlook to its rating.

Although the state is a prolific issuer of bonds, it has only \$2.6 billion of general obligation debt outstanding, compared to nearly ten times that amount in issues secured through contracts and leases, by the state's promise to pay, subject to annual state appropriation. Other issues include revenue bonds, a few of which are moral obligations of the state. Finally, state agencies issue conduit debt for which the state has no financial responsibility, with security provided by the underlying issuer. Key information about the state includes:

- New Jersey ranks second behind Connecticut in per capita income, which was \$50,313 in 2009.
- The state has an elevated level of debt and liabilities. A recent Moody's report comparing the combination of tax supported debt and unfunded pension liabilities as a percent of GDP, ranked New Jersey as ninth highest of the fifty states. Pension funding is 56.4% as of June 2010, well below the 80% level considered adequate by many analysts.
- State tax revenue from income and sales taxes grew by 8.1% in 1st Q 2011 compared to 1st Q 2010. This compares to a 9.3% increase for all states.
- The Philadelphia Fed Index of Economic Activity indicates 1.0% growth YoY through May 2011, compared to 2.2% for all states.
- The unemployment rate for New Jersey was 9.5% in June, compared to 9.2% nationally. This is the highest rate for New Jersey since May 2010.

The Transportation Trust Fund and School Construction Program account for nearly 1/3 of the state's debt.

GENERAL OBLIGATION DEBT

- Aa3/AA-/AA (Fitch outlook is negative)
- Moody's and S&P lowered the state's bond ratings earlier this year, leaving ratings below those of any state except California and Illinois.

APPROPRIATION BACKED DEBT

New Jersey uses appropriation backing as primary or secondary security for about \$30 billion in bonds. Unlike GO bonds, which are secured by the full faith, credit and taxing power of the state, these issues are backed by a promise of the state, evidenced by a contract or lease, to pay funds towards debt service. Moneys for debt service must be appropriated annually by the legislature. Historically, there has been no failure of the state to appropriate funds in a timely manner.

Rating agencies generally rate appropriation backed debt one notch below GOs, although there are exceptions. Moody's considers the essentiality of the program's underlying purpose. NJ GOs are rated Aa3/AA-/AA so the majority of appropriation issues are A1/A+/AA- (negative outlook from Fitch). Certain issues, as explained more completely below, have specific revenue streams behind them, which can lead to a lower rating (Cigarette Tax) or higher rating (Garden State Preservation Trust).

The New Jersey Transportation Trust Fund Authority is the largest issuer of appropriation bonds, accounting for about 37% of outstanding appropriation debt, while the New Jersey Economic Development Authority (NJEDA) issues bonds on behalf of twenty state initiatives ranging from the school facilities construction program to special needs housing secured by motor vehicle surcharges. In total there are 35 programs financed through 10 issuers. Some of the larger programs are noted below.

TRANSPORTATION TRUST FUND AUTHORITY

- A1/A+/AA-
- \$11 billion outstanding
- Secured by payments from the state under a 2006 contract, subject to annual legislative appropriation.
- In addition to general funds, certain constitutionally dedicated taxes and revenues are available, subject to legislative appropriation, including portions of motor fuels tax, gross receipts tax on petroleum products and sales tax on new vehicles.
- The authority finances projects, repairs and improvements to the state transportation system, which includes road and highway infrastructure as well as the commuter rail, light rail and bus lines of the NJ Transit system.

SCHOOL FACILITIES CONSTRUCTION (NJEDA)

- A1/A+/AA-
- \$8.2 billion outstanding
- Secured by payments from the state under a 2001 contract, subject to annual legislative appropriation.
- As established by 2000 Educational Facilities Act, proceeds are used to finance costs of public school facility construction projects in the state.

The Garden State Preservation Trust is among the strongest credits in the state, with a constitutionally dedicated revenue stream.

GARDEN STATE PRESERVATION TRUST

- Aa3/AAA/AA
- \$1.1 billion outstanding
- Although subject to annual appropriation, bonds are secured by a constitutional dedication of certain state sales tax revenues.
- Legislature may not use dedicated funds for any purpose other than bond debt service.
- Bond proceeds are used for open space conservation and recreational projects.

BUILDING AUTHORITY

- A1/A+/AA-
- \$660 million outstanding
- Secured by lease payments from the state, subject to annual legislative appropriation.
- The authority finances acquisition, construction and improvement of office buildings and other facilities which are leased to the state or state agencies.

SPORTS AND EXPOSITION AUTHORITY

- A2/A+/AA-
- \$610 million outstanding
- Bonds are secured by state contract payments, subject to annual appropriation.
- The authority owns Meadowlands racetrack, Izod Arena, Monmouth Park racetrack and other facilities. Authority owned old Giants/Jets stadium, which was torn down in 2010 and replaced with new stadium, not owned by Authority. Bonds are secured through state contract and not by revenues derived from these facilities.
- The authority also has \$118 million outstanding (12-31-09), primarily convention center Luxury Tax bonds, which are secured by tax levied in Atlantic City. They are rated Baa1/BBB due to National Insurance, and have no state backing.

CERTIFICATES OF PARTICIPATION

- A1/A+/NR
- \$911 million outstanding
- Secured by lease payments from state for NJ Transit equipment.
- Used to finance purchase of train cars and locomotives.

HEALTH CARE FACILITIES FINANCING AUTHORITY

- A1/A+/AA-
- Although most Health Care Facilities issues are conduit, with the rating reflecting the underlying borrower, two issues are secured by state contracts.
- \$444 million, secured by a state contract, subject to annual appropriation, financed the Hospital Asset Transformation program, which assisted nonprofit hospitals with expense, including retirement of debt, of closing down or transforming facilities no longer needed.
- \$192 million, secured by a state contract subject to annual appropriation, financed renovation and construction of state owned Greystone Park Psychiatric Hospital.

Declining cigarette consumption may erode the revenue base of Cigarette Tax Revenue bonds.

The student loan program has never needed to draw on the state's moral obligation pledge.

LIMITED APPROPRIATION DEBT

Although subject to legislative appropriation, amounts to be appropriated for debt service on the Cigarette Tax Revenue and Motor Vehicle Surcharge revenue issues are limited to specific revenues. As a result these issues have lower ratings than other appropriation backed debt.

MOTOR VEHICLE SURCHARGE FUND (NJEDA)

- A1/A/NR (senior) and A3/A/NR (sub)
- \$1.2 billion outstanding
- Proceeds are used to fund Motor Vehicle Commission facilities, grants and loans for special needs housing projects and general use by state.
- Secured by contract with state based on amounts in the motor vehicle surcharge fund and unsafe driver surcharge funds, subject to annual legislative appropriation.
- Seniors will be paid off by 2015.
- Available revenues covered debt service 1.45x in 2010 (S&P).

CIGARETTE TAX REVENUE (NJEDA)

- Baa3/BBB/BBB+ (Moody's outlook is negative)
- \$1.1 billion outstanding
- Appropriation backed, but unlike most NJ appropriation backed debt, limited to available revenues.
- A portion (18.9%) of state's \$2.70 per pack tax is deposited to a dedicated fund to be used to pay debt service. Bondholders have no lien on these revenues, with debt service subject to annual appropriation.
- Cigarette consumption is declining, due in part to rising state and federal excise taxes and legislation limiting smoking in workplaces.
- Debt service coverage is narrow, 1.15x in 2010, and projected by S&P to fall below 1.0x by 2028 (assuming 4% annual consumption decline).
- Excess revenue can and has been used to retire bonds prior to maturity, lowering future debt service requirements and likely improving debt service coverage margins.

REVENUE ISSUES

Revenue debt is backed by a specific revenue source. With the exception of South Jersey Port Authority and the Higher Education Assistance Authority, both of which are moral obligations of the state, revenue issues are secured only by the revenue stream of the underlying program. A moral obligation is similar to appropriation backed debt, except there is no specific underlying contract or lease.

HIGHER EDUCATION STUDENT ASSISTANCE AUTHORITY – STUDENT LOAN PROGRAM

- Aa3/AA/A – some variation with individual issues
- \$2.2 billion outstanding
- Much of outstanding debt is variable rate.
- Secured by student loan repayments. Security points, based on Moody's May 2011 report, include high quality of underlying loans (2.5% expected losses), 5.1% overcollateralization and, excess spread of 2.5% to 3.5% (difference between borrowing costs and rate on student loans).
- State acknowledges a "moral obligation" to make up deficiencies in amounts needed for debt service, but this has never been needed.
- Issuer has statutorily authorized powers such as administrative wage garnishment, which provide program with higher collections than other non-NJ student loan programs.

Environmental Infrastructure Trust bonds carry top ratings.

ENVIRONMENTAL INFRASTRUCTURE TRUST

- Aaa/AAA/AAA (see note below)
- \$1.5 billion outstanding
- Bond proceeds are loaned to primarily to NJ communities to finance clean drinking water and wastewater treatment projects and related environmental and “green” projects.
- The loans are funded partially by bond proceeds and partially by state matching funds, but all loan repayments secure bonds, generating significant overcollateralization.
- Proceeds of individual issues are lent to specific communities and companies, but a Master Program Trust, on a backup basis, secures all but a few loans, which may not be AAA rated.
- 90% of more than 300 borrowers provide a GO pledge to secure loans. Trust has right to intercept state aid to a community if debt service payment is thirty days late.
- Cash flow covers debt service by minimum of 1.8x. A Nov 2010 Moody’s report estimates program could tolerate a default rate as high as 45%.

NJ HOUSING AND MORTGAGE FINANCE AGENCY – SINGLE FAMILY PROGRAMS

- \$1.3 billion 2003 Resolution outstanding – Aa2/AA/NR
- \$254 million 2009 Resolution with NJHMFA guarantee – Aa1/AA/NR
- Primary security is underlying individual mortgages and associated cash flows.
- Loan standards are generally high – if LTV>80%, then Federal (FHA, VA, RHS) or Private Mortgage Insurance (PMI) required. About 20% of loans have PMI.
- 4th Q delinquency rate was 13.58% compared to overall state level of 13.06%.

NJ HOUSING AND MORTGAGE FINANCE AGENCY – MULTIFAMILY HOUSING

- NR/A+/NR
- \$1.2 billion outstanding
- Although there are four multifamily resolutions, the vast majority of debt is issued under 1995 and 2005 resolutions, both of which carry the same rating.
- Proceeds finance multiple unit apartment buildings for low and moderate income renters.
- Approximately 34% of projects are in subsidized federal programs under sections 8 and 236.
- Occupancy of various projects averages about 95%.

NEW JERSEY TURNPIKE AUTHORITY

- A3/A+/A
- \$8.4 billion outstanding
- The authority owns the NJ Turnpike as well as the Garden State Parkway, about 300 miles of roads. Both are essential roads with minimal high speed non-toll road alternatives.
- Secured by senior lien on net system revenues. All bonds are issued as parity bonds, with no subordinate lien issues.
- Two stage toll increase passed and approved in 2008. First stage implemented Dec 2008 and second is scheduled for Jan 2012. Senate voted to rescind 2012 increase, but there has been no further action from Assembly.
- Moody’s assigned negative outlook in Dec 2010 over concerns of revenue siphoning for non-turnpike purposes, primarily for unrelated or marginally related transportation projects.
- Debt service coverage projected at 1.48x to 1.74x from 2011 to 2018 (S&P).

Bonds of the New Jersey Turnpike Authority are secured by toll revenue from the Turnpike as well as the Garden State Parkway.

Bonds secured by tobacco settlement revenues are rated below investment grade by Standard and Poor's.

State credit enhancement programs add security to and lower interest costs for school districts and community colleges.

TOBACCO SETTLEMENT FINANCING CORP

- 2012 to 2019, 2023, 2026 maturities - Baa3/BBB/NR
- 2029 maturity - Baa3/BBB-/NR
- 2034 maturity - Baa3/BB+/NR
- 2041 maturity - Baa3/BB-/NR
- \$3.1 billion outstanding
- Secured by flow of payments from cigarette manufacturers under 1998 Master Settlement Agreement (MSA) of state health care claims (NJ was one of 46 states signing agreement). About 76% of tobacco settlement revenues (TSRs) received by state secure the bonds.
- TSR amounts are volatile with several factors, particularly the rate of US cigarette consumption, impacting the revenue stream. NJ's annual payment has ranged from \$227 million to \$287 million in past 5 years. The trend for cigarette consumption is negative.

CONDUIT FINANCING

Conduit issuers include the New Jersey Economic Development Authority (NJEDA), New Jersey Health Care Facilities Authority (NJHCFA) and New Jersey Educational Facilities Authority (NJFEA). When acting as conduit issuers, these agencies have no liability for debt service payments, acting as a go between for borrowers and bondholders. NJEDA issues bonds for universities ranging from Princeton University (Aaa/AAA/NR) to Seton Hall University (A3/A/NR) and others. NJHCFA is a conduit for nonprofit hospitals, while NJEDA borrows on behalf of corporations to encourage economic activity and growth. In all of these cases the obligor is the institution or company, with the state having no financial responsibility.

CREDIT ENHANCEMENT PROGRAMS

New Jersey has three programs to enhance credit for certain local issuers. In some cases the underlying rating of the issuer may be above the credit enhancement rating.

SCHOOL BOND RESERVE ACT

- Aa2/AA-/AA
- Backed by Chapter 72 School Bond Reserve program with assets equal to 1% of total school district debt in state (1.5% for debt issued pre Jul 2003).
- If needed, state treasurer applies money from the fund to purchase maturing principal and pay interest.
- If fund falls below required levels, state treasurer is required to appropriate amounts needed to bring fund up to requirement.

QUALIFIED BOND PROGRAM

- A1/A+/AA- (some Moody's ratings are A2 if state aid does not amply cover debt service).
- State treasurer is required to withhold appropriated state aid sufficient to pay debt service on qualified bonds and forward to paying agent before due date.

ADDITIONAL STATE AID BOND PROGRAM

- A1/A+/NR
- State appropriates funds for debt service for qualified community college projects.

Port Authority of New York and New Jersey is one of most prolific issuers in the country.

After widening earlier this year, New Jersey's credit spreads have narrowed, but remain above those of neighboring states.

BI-STATE AGENCIES

New Jersey participates in several bi-state agencies. Bonds of these agencies are secured by specific revenues of underlying projects and assets. The two largest are:

PORT AUTHORITY OF NEW YORK-NEW JERSEY

- Aa2/AA-/AA-
- \$13.3 billion outstanding
- Owns and operates significant strategic transportation systems in New York Metropolitan Area including JFK, LaGuardia and Newark Airports; Holland and Lincoln Tunnels; George Washington, Goethals and Outerbridge Crossing bridges; Port Authority Bus Terminal; PATH light rail; and the World Trade Center site.

DELAWARE RIVER PORT AUTHORITY (NEW JERSEY AND PENNSYLVANIA)

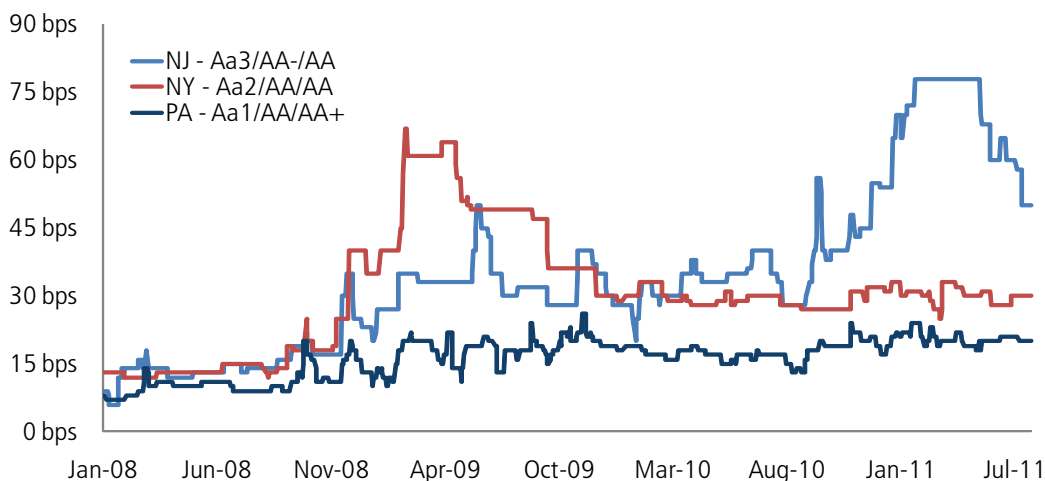
- A3/A-/NR (senior) and Baa3/BBB- (Port District)
- \$1.37 billion outstanding
- Owns and operates four bridges between Pennsylvania and New Jersey as well as PATCO light rail system.

NEW JERSEY GENERAL OBLIGATION TRADING LEVELS

The yield differential between bonds of a AAA rated benchmark such as MMD, and a specific issuer are indicative of the market's perception of credit risk. New Jersey spreads were similar to those of two neighboring states for most of 2008, rising from 6 bps to about 35 bps towards year end, as the municipal market was caught in the liquidity crunch of the financial crisis. Both NY and NJ were particularly impacted by Wall Street consolidation and employment declines in the post Lehman period.

In September 2010, citing high unfunded pension liabilities and elevated debt levels, Moody's placed a negative outlook on the state's rating. By February 2011, spreads had widened from 28 bps to a high of 78 bps. S&P dropped the rating to AA- from AA in February 2011 and in April Moody's lowered its rating to Aa3 while Fitch assigned a negative outlook. As we noted in a May 2011 report titled "NJ Bond Oversold," the spreads seemed higher than justified by state finances. Since May, spreads have narrowed significantly, with recent trading indicating a 50 bps spread.

Ten Year Maturity NJ and Comparable State Yield Spreads



Source: Thomson MMD, Janney FIS.

The state's underlying wealth and diverse economy are positive credit considerations.

CONCLUSION

After many years of prosperity and borrowing, New Jersey was hit harder by the Great Recession than many states, particularly impacted by its proximity and exposure to the financial services sector. Recovery is underway, but the pace is slow compared to the country as a whole, as the high cost of living and doing business in the state act as a drag on recovery. Underfunded pensions and high levels of tax supported debt are ongoing concerns.

The state's underlying wealth and diverse economy are positive credit considerations. The administration has been proactive in addressing challenges, implementing the beginnings of pension reform and closing the FY2012 budget gap with significant spending reductions. Despite political pressure, the governor has resisted tax increases, an important element of recovery in a state with one of the highest tax burdens in the country.

Although a double dip recession could set the state's recovery back, we believe the financial trend for New Jersey is positive, with recent credit spreads appropriate for the state's credit profile.

New Jersey Tax Supported Bonds - June 30, 2010

| Bond Program | Amount | Notes | Ratings |
|--|-------------|---|------------|
| General Obligation | | | |
| General Obligation | \$2,597 MM | Full faith, credit and taxing power | Aa3/AA-/AA |
| Appropriation Backed Debt | | | |
| Garden State Preservation Trust | \$1,110 MM | Constitutionally dedicated amount from state sales tax | Aa3/AAA/AA |
| NJ Building Authority | \$662 MM | Funds construction and improvement of state office buildings | A1/A+/AA- |
| NJ Certificates of Participation | \$912 MM | Finances equipment for NJ Transit | A1/A+/NR |
| NJ Economic Development Authority | | | |
| Business Employment Incentive Program | \$147 MM | Taxables - funds used to promote growth of high tech businesses in state | A2/A+/AA- |
| Economic Recovery Fund | \$160 MM | Loans, guarantees and investments for economic development | A1/A+/AA- |
| Municipal Rehabilitation | \$161 MM | Finances projects for distressed municipalities - primarily Camden | A1/A+/AA- |
| Municipal Rehabilitation | \$161 MM | Finances projects for distressed municipalities - primarily Camden | A1/A+/AA- |
| NJ Transit Light Rail System | \$364 MM | Financed River Line which connects Trenton and Camden | A1/A+/AA- |
| School Facilities Construction | \$8,156 MM | Finances school construction and improvement projects | A1/A+/AA- |
| State Pension Funding | \$2,530 MM | Taxable issues used to fund state pension plans | A1/A+/NR |
| NJ Educational Facilities Authority Capital Improvement Fund | \$433 MM | Funds grants for capital improvements to public and private higher education institutions | A1/A+/AA- |
| NJ Health Care Facilities Financing Authority | | | |
| Greystone Park Psychiatric Hospital | \$192 MM | State Psychiatric Hospital | A1/A+/AA- |
| Hospital Asset Transformation Program | \$444 MM | Finances non profit hospital facility closings | A1/A+/AA- |
| NJ Sports and Exposition Authority | \$610 MM | Meadowlands and Monmouth Racetrack and other facilities | A2/A+/AA- |
| NJ Transportation Trust | \$11,090 MM | Finances projects for state transportation system | A1/A+/AA- |

Source: New Jersey CAFR and other financials, Moody's, S&P, Fitch and Janney FIS.

New Jersey Revenue Secured Bonds - June 30 or December 31, 2010

| Bond Program | Amount | Notes | Ratings |
|--|------------|---|---|
| Appropriation - Amount Limited to Specific Revenues | | | |
| NJ Economic Development Authority | | | |
| Cigarette Tax Revenue | \$1,139 MM | A portion of state cigarette tax deposited to dedicated fund | Baa3/BBB/BBB+ |
| Motor Vehicle Commission | \$160 MM | Senior lien on motor vehicle surcharges with proceeds used to finance renovation and construction of commission facilities | A1/A/NR |
| Motor Vehicle Surcharge Revenue | \$1,014 MM | Funds from unsafe driving surcharges and sub lien on motor vehicle surcharges | A3/A/NR |
| Revenue Bonds - Moral Obligation | | | |
| Higher Education Student Assistance Authority | \$2,217 MM | Self supporting program for student loans. State "moral obligation." | Aa2/AA/A Aa3/AA/A |
| South Jersey Port Corporation | \$296 MM | Revenues derived from several marine terminals. State acknowledges moral obligation to replenish debt service reserve fund. State has made payments ranging from \$6.5 to \$11.5 million 2006 through 2010. | A1/A-/NR |
| Revenue Bonds - No State Backing | | | |
| Casino Reinvestment Development Authority | \$353 MM | Backed by parking fees and hotel room fees collected in Atlantic City | A3/A-/NR |
| NJ Environmental Infrastructure Trust | \$1,458 MM | Revolving Fund to support clean water. Loans to NJ communities. Strong debt service coverage. | Aaa/AAA/AAA |
| NJ Housing and Mortgage Finance Agency | | | |
| Single Family 2003 Resolution | \$1,256 MM | Proceeds finance mortgage loans for purchasers of owner occupied single family homes | Aa2/AA/NR |
| Single Family 2009 Resolution | \$254 MM | Proceeds finance mortgage loans for purchasers of owner occupied single family homes. GO backing of NJHMFA | Aa1/AA/NR |
| Multi Family 1995 and 2005 Ressionation | \$1,060 MM | Proceeds finance multiple unit apartment buildings including section 8 and 236 subsidized units. | NR/A+/NR |
| NJ Turnpike Authority | \$8,423 MM | Toll revenues from NJ Turnpike and Garden State Parkway | A3/A+/A |
| South Jersey Transportation Authority | \$493 MM | Revenues from Atlantic City Expressway and Atlantic City International Airport | Sen - Baa1/A-/BBB+ Sub - Baa1/BBB/BBB- |
| Tobacco Settlement Financing Corp | \$3,092 MM | Secured by revenues from Master Settlement Agreement | Moody's Baa3 S&P BB- to BBB |

Source: New Jersey CAFR and other financials, Moody's, S&P, Fitch and Janney FIS.

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