

MUNICIPAL BOND MARKET NOTE

JANNEY FIXED INCOME STRATEGY

June 15, 2010



Suggestions of factors stressing the municipal market are overblown in the June 14, 2010 Wall Street Journal and many other recent articles.

Most municipal market credits, unlike sub-prime loans or dot-com stocks, are solid investments and will continue to pay principal and interest until maturity.

Harrisburg, PA is likely to file for Pennsylvania's Act 47 oversight program, while Central Falls, RI will likely find itself under the purview of a state overseer such as the Rhode Island State Review Commission.

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The Reality of the Factors Stressing the Municipal Bond Market

- Investors are considering the reality of factors stressing the municipal market including: lower but stabilizing revenues, political obstacles, a difficult budget cycle, uncertainty about further federal government stimulus and the direction of the US economy.
- It is likely that the level of defaults and bankruptcies will rise above historical trends but there is no evidence to suggest that there is going to be a "Municipal Meltdown."
- Janney Fixed Income Strategy recommends municipal investors possess a diversified portfolio of high quality municipal bonds.

MUNICIPAL CREDIT MARKET COMMENTARY

Experienced municipal market investors are conscious of the factors stressing the municipal bond market. It is these same experienced investors and analysts who are looking past the headlines prevalent in recent press accounts, the latest installment being a June 14, 2010 Wall Street Journal article titled, "Investors Looking Past Red Flags in Muni Market." Suggestions of factors stressing the municipal market are overblown in this and many recent articles. These articles are from reporters and outside observers proposing that the municipal market will be the next market bubble to burst, ala the sub-prime mortgage market or the dot-com stock bubbles. A key difference is that most municipal market credits, unlike sub-prime loans or dot-com stocks, are solid investments and will continue to pay principal and interest until maturity. Experienced investors are concentrating on the reality of the factors stressing the municipal market which include: lower but stabilizing revenues; political obstacles; a difficult upcoming fiscal year budget cycle; uncertainty about further federal government stimulus; and the direction of the US economy. Hefty pension and health benefit liabilities exist, but are a medium to long term credit risk as payments can be postponed, despite additional future expense incurred from deferring their payment. Municipal market investors should not overreact to doomsday scenarios and incidents with extenuating circumstances.

Some municipal issuers have cut spending and raised taxes or user fees in response to lower revenues. It is forecast that some will have to drastically cut spending on schools, police, fire and other essential services to levels that may be detrimental to municipalities' ability to deliver public sector services and hinder financial recovery. President Obama included state and local aid as part of the 2009 American Recovery and Reinvestment Act and this weekend reached out to legislators asking for additional state and local support. As for effects to smaller municipalities, we believe incidents such as the Vallejo, CA bankruptcy filing, Harrisburg's (PA) fiscal situation and Central Falls, RI filing for temporary receivership will be the exception rather than the rule. By and large the pace of municipal defaults increased slightly since July 2009 but, default activity is still mostly in the riskier municipal sectors and almost non-existent in the traditional municipal sectors including general obligation, tax backed and essential service areas. As far as the risk of Chapter 9 municipal bankruptcy is concerned- there were an average of 8 municipal bankruptcies a year since 1934, according to the American Bankruptcy Institute- versus thousands of Chapter 11 filings annually. It is likely that the level of municipal defaults and bankruptcies will rise above historical levels. But, there is nothing to suggest that there is going to be a "Municipal Meltdown" or a high proportion of municipal bankruptcies and defaults, especially among issuers of traditional municipal bonds.

In all, we expect some states and municipalities may experience credit deterioration and that there may be an increase in the number of defaults or municipal bankruptcy filings to slightly above historical averages. We also anticipate credit spreads will be volatile and some states, especially those with delayed budgets will experience spread widening. The Janney Fixed Income Strategy approach to the factors currently stressing the municipal market is to diversify into high quality municipal bonds. Municipal investors should be concentrating on high quality general obligation issues, across different states, and avoid those highly dependent upon an elevated level of government aid. Diversifying across higher quality essential service and revenue bonds sold by large and established issuers should also be considered. **Tom Kozlik**

Analyst Certification

I, Tom Kozlik, the Primarily Responsible Analyst for this report, hereby certify that all of the views expressed in this report accurately reflect our personal views about any and all of the subject sectors, industries, securities, and issuers. No part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

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Treasuries: Janney FIS ratings employ the "Barclay's U.S. Treasury Index" as a benchmark.

Agencies: Janney FIS ratings employ the "Barclay's U.S. Agency Index" as a benchmark.

Mortgages: Janney FIS ratings employ the "Barclay's U.S. MBS Index" as a benchmark.

Investment Grade Credit: Janney FIS ratings employ the "Barclay's U.S. Credit Index" as a benchmark.

High Yield Credit: Janney FIS ratings for employ "Barclay's U.S. Corporate High Yield Index" as a benchmark.

Municipals: Janney FIS ratings employ the "Barclay's Municipal Bond Index" as a benchmark.

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