Weekly Trading Desk Update

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Trading Desk Commentary

The (A1/A) State of California and the (A2/A-) State of Illinois are respectively showing what to do and what not to do when times get tough. Each state is often compared to one another due to their dubious distinction of holding the two lowest state GO ratings in the country. Both were hit particularly hard by the Great Recession and have suffered a spate of downgrades in the period since. California's unemployment rate soared in the wake of the crisis and the state continues its glacial recovery from its own housing collapse. Illinois, notorious for questionable management decisions, ineffective leadership, and massive pension shortfalls has wrestled with their own set of issues since the economic downturn. Fast forward to today, and it seems California may be ready to put Illinois a bit further in its rear-view mirror. Rating agencies and analysts spent most of this week touting California and commending not only how far the state has come but the initiatives put in motion to address its major issues. Gov. Brown spent the better part of 3 years pushing for higher taxes on the wealthy coupled with austerity measures to bring the state's budget back in balance. In November, 54% of California voters passed Proposition 30 and the state now appears on track for its first budget surplus in years. California still has plenty of work to do, especially in the labor department where its unemployment rate far outpaces the national average. S&P rewarded the largest Muni issuer in the US with a one-notch upgrade on Thursday. Meanwhile, Illinois ended its most recent budget session without any new measures to address its ballooning pension obligations and was smacked with a one-notch downgrade on Friday by S&P. All 3 major ratings agencies have the state on negative outlook, meaning further downgrades are a real possibility. Illinois' borrowing costs versus the AAA benchmark have grown significantly in recent weeks – to the point that the state delayed its recent sale of $500mln new GO debt indefinitely. Without some progress from Illinois' legislature, the state's recent pain could only be the beginning.

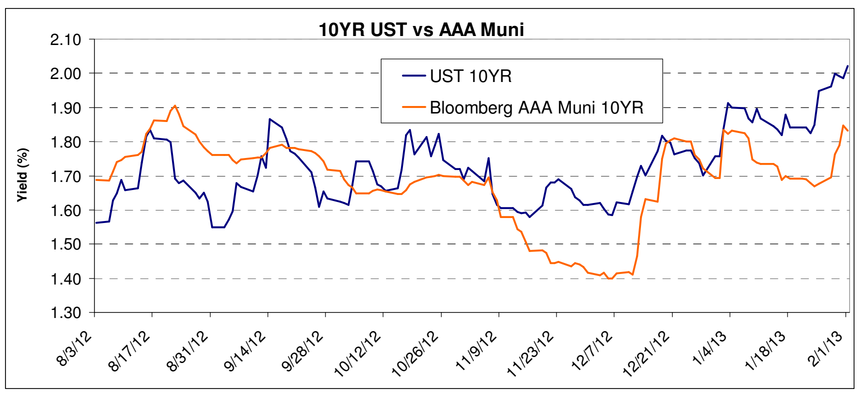
Overall, the week felt very stable other than a little softening in US Treasuries forcing a small concession out of tax-exempts. Dealers seemed pleased with the results of their primary debt sales, even in high-grade names (like the $325mln (Aaa/AAA) State of North Carolina GO), despite the stubbornly low yield environment in which we still find ourselves. Next week, only $4.2bln in new issuance is scheduled to come to market, a manageable number even in a slow market. However, ongoing Muni fund flows and strong interest in the primary market continues to portray a Muni market on firm footing. As of now, no deal next week will exceed $500mln, meaning the limited supply will be spreads out over dozens of smaller loans. This usually helps conceal any deals that may struggle as long as the majority appears to be selling at reasonable levels. There are several revenue and GO deals that should pique our interest, but we continue to try to capitalize on most traders overlooking the secondary market, where we continue to find pockets of attractive offerings. Calibrating one's focus too narrowly on the primary market means running the risk of missing out on some of Muniland's most attractive opportunities. On Monday, the hunt continues.

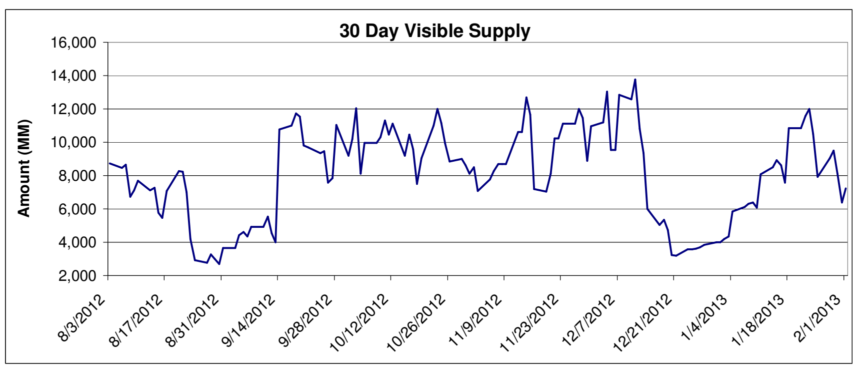
Muni Rates	Current Wk	Yld Change	Prior Wk	Muni to UST
2 Year	0.34	0.01	0.33	131%
5 Year	0.79	0.04	0.75	89%
10 Year	1.82	0.07	1.75	90%
30 Year	2.86	0.07	2.79	89%
UST Rates				
2 Year	0.26	-0.02	0.28	
5 Year	0.89	0.02	0.87	
10 Year	2.03	0.08	1.95	
30 Year	3.22	0.09	3.13	

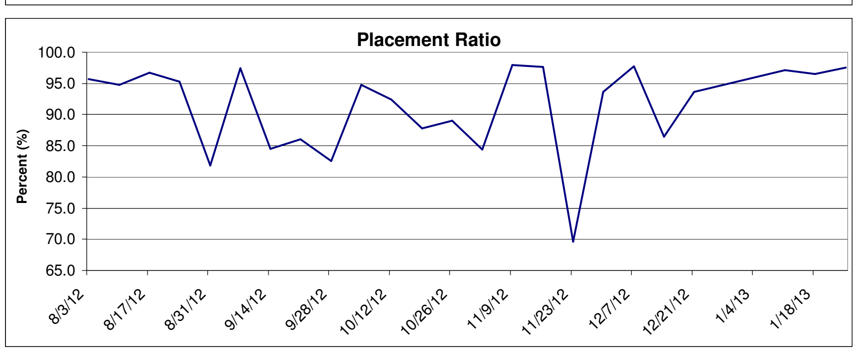
	Current Wk	Prior Wk
Weekly Municipal Supply ($ Bln)		
Negotiated	$2.50	$4.59
Competitive	$1.79	$1.78
TOTAL	**$4.29**	**$6.37**
Municipal 30 Day Visible Supply ($ Bln)	**$7.22**	**$7.91**
Bloomberg Muni PICK Offerings ($ Bln)	**$13.20**	**$11.65**
Muni Placement Ratio (New Issues)	**n/a**	**97.5%**
Bond Buyer 20 Municipal G.O. Index	**3.67%**	**3.54%**

Select Economic Releases

Date	Event	Period	Survey	Prior
2/4	Factory Orders	Dec	2.3%	0.0%
2/5	ISM Non-Manf. Composite	Jan	55.0	56.1
2/6	MBA Mortgage Applications	1-Feb	--	-8.1%
2/7	Nonfarm Productivity	4Q P	-1.4%	2.9%
2/7	Unit Labor Costs	4Q P	2.9%	-1.9%
2/7	Initial Jobless Claims	2-Feb	360K	368K
2/7	Continuing Claims	26-Jan	3195K	3197K
2/8	Wholesale Inventories	Dec	0.4%	0.6%







Please refer to the second page for explanations of key measures, sources, and disclosure information.

Explanation of Key Measures :

Weekly Municipal Supply - The total dollar volume of municipal securities expected to be offered during the upcoming week, broken down by deal type. This helps gauge near term supply and momentum along with the 30 day visible figure.

30 Day Visible Supply - The total dollar volume of municipal securities expected to be offered over the next 30 days. The visible supply, which is compiled and published by The Bond Buyer, indicates the near-term activity in the municipal market.

Bloomberg PICK Offerings - The total dollar amount of offerings listed on Bloomberg's dealer offerings system. The figure helps gauge secondary supply in the market.

Placement Ratio - The amount of bonds sold by underwriting syndicates each week as a percentage of the amount issued that week by issuers selling $1,000,000 par value or more of securities. The ratio published by The Bond Buyer, helps gauge the demand for municipal bonds in the marketplace.

Bond Buyer 20 G.O. Index - Index published weekly representing the average yield of 20 G.O. bonds with 20 year maturities, rated AA2 by Moody's.

Sources: Weekly municipal supply figures, and municipal rates are produced by Thompson Reuter (Municipal Market Data). 30 day visible figures, and the placement ratio are obtained through The MuniCenter, and produced by The Bond Buyer. The 20 G.O. index yield is obtained through Bloomberg, and produced by The Bond Buyer. Pick offerings par value, UST supply, economic releases, and UST rates are obtained through Bloomberg Professional Service. Information obtained from these sources is believed to be reliable but is not guaranteed.