

Trading Desk Commentary

In January of this year, Moody's made Illinois the lowest-rated state following its one-notch downgrade to A2 from A1 due to a severely under-funded pension plan and poor budgeting practices. S&P has maintained its A+ rating on Illinois debt but has kept the state on "negative watch" since January 2011. The state's ongoing fiscal troubles have been well-publicized – along with its historic tax hike in an effort to close its gaping budget deficit. It's state and local leaders have been called inept at best and criminals at worst. Last week, almost one-quarter of the total supply calendar was concentrated in a highly anticipated \$1.8bln (A2/A+) State of Illinois GO deal. The deal would show if investors would be squeamish toward such a credit profile or if they could stomach risk in favor of finding some incremental yield. By all accounts, the deal was highly sought-after and provided a clear answer: Bring on the yield.

The remaining \$5bln in new issuance was scattered across a wide array of credit profiles and sectors, providing for a large menu to select from, but small portions. We participated in several new issues last week in the GO, housing, and healthcare sectors. We still believe that value can be located in higher yielding sectors despite the large spread tightening we have seen since supply began to tail off in March. With no end in sight to the current supply shortage, we suspect participants will continue to reach for yield – and current holders of lower-rated debt will benefit. However, prudent credit selection remains paramount in any strategy looking to buy lower rated debt. As always, it is crucial to emphasize one main objective – "know what you own."

Our current outlook for the Muni market remains bullish for several reasons: paltry supply, \$60bln in reinvestment activity expected through June, attractive ratios, a softer US economic outlook, and the return of the Eurozone concerns. We think our positioning slightly long of our intermediate Muni benchmark should serve us well in upcoming weeks. Until the US starts producing some better economic data, Europe improves, and/or the visible supply calendar expands, Munis (esp. high yield and long maturities) could be expected to hold steady.

Muni Rates	Current Wk	Yld Change	Prior Wk	Muni to UST
2 Year	0.31	0.00	0.31	124%
5 Year	0.80	-0.02	0.82	103%
10 Year	1.82	-0.05	1.87	97%
30 Year	3.15	-0.10	3.25	103%

UST Rates

2 Year	0.25	-0.01	0.26
5 Year	0.78	-0.04	0.82
10 Year	1.87	-0.06	1.93
30 Year	3.07	-0.04	3.11

	Current Wk	Prior Wk
Weekly Municipal Supply (\$ Bln)		
Negotiated	\$4.18	\$5.13
Competitive	\$1.68	\$0.72
TOTAL	\$5.86	\$5.85

Municipal 30 Day Visible Supply (\$ Bln)	\$8.38	\$7.96
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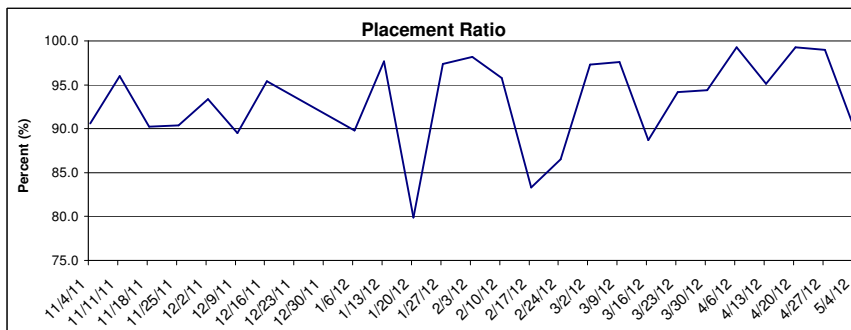
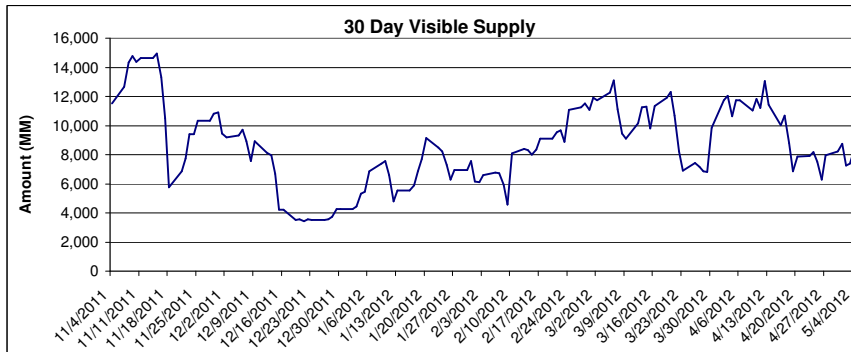
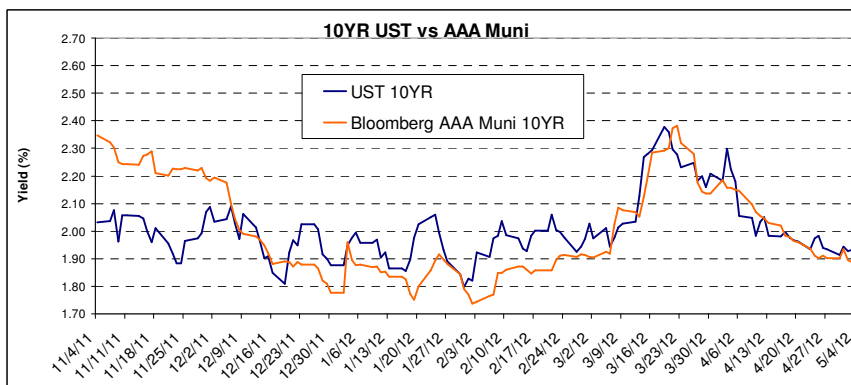
Bloomberg Muni PICK Offerings (\$ Bln)	\$9.94	\$13.38
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Muni Placement Ratio (New Issues)	90.00%	97.30%
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Bond Buyer 20 Municipal G.O. Index	3.81%	3.86%
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Select Economic Releases

Date	Event	Period	Survey	Prior
5/9	MBA Mortgage Applications	4-May	--	0.10%
5/10	Import Price Index (MoM)	APR	-0.20%	1.30%
5/10	Initial Jobless Claims	5-May	370K	365K
5/10	Continuing Claims	28-Apr	3273K	3276K
5/11	Producer Price Index (MoM)	APR	0.00%	0.00%
5/11	PPI Ex Food & Energy (MoM)	APR	0.2%	0.3%
5/11	U. of Michigan Confidence	MAY P	76.0	76.4



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.

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