

Trading Desk Commentary

Last Thursday, Stockton, California became the largest city to file for bankruptcy in US history. Due to overly generous pension plans for city employees and a severe housing downturn, the city finds itself incapable of meeting its current debt obligations. Stockton is home to roughly 300,000 residents and lies 80 miles east of downtown San Francisco. Though talks between the city and creditors had remained confidential, the city's fiscal woes were hardly a secret. Early this year, the severity of Stockton's shortfalls made national headlines, beginning a 6-month process culminating in last week's filing. Some observations: 1) the Muni market took the telegraphed default in stride and has actually rallied since the bankruptcy was declared. This result is in stark contrast to the panicked reaction that we saw to the well-publicized 2010 prediction of widespread Muni defaults that has yet to materialize. Participants now appear more comfortable with the isolated, idiosyncratic nature of unique Muni issuers and potentially better understand the concept of underlying credit-worthiness. 2) Stockton's decision is reason for some concern. What will be the fallout of such a large entity using Chapter 9 bankruptcy to prevent a disorderly default? How much of the losses will be passed along to debtholders? Other struggling municipalities will be watching closely to assess the viability of bankruptcy as an option as well as the side effects. The implications of Stockton's bankruptcy may be more widespread than we realize. The proceedings will likely take months to conclude so the effects of how Stockton's case is handled will take some time to realize. Hopefully, the courts will place an appropriate amount of the burden on Stockton's shoulders (as opposed to being too punitive to the city's creditors), or run the risk of seeing other municipalities follow Stockton's blueprint.

Next week's Muni supply calendar returns to a more normal state – with roughly \$7bln expected to be sold. The number still feels very manageable given the lack of options offered up this week and the continued reinvestment of recent maturities. Furthermore, the 10-year US Treasury bond yields experienced a 10 basis points (0.10%) rally over the week while AAA Muni yields were only able to carry a fraction of that strength. That is likely due in large part to the limited trading volume in the Municipal space through the Independence Day holiday. We may see Munis playing a little catch up at the beginning of next week, when new supply and fully-staffed desks return and allow the market a better chance to react to this week's developments. Munis did show a little sign of life today (Friday) following a disappointing Nonfarm payroll number. US Treasuries mustered their best performance of the week as a result, and Munis were forced to show a little improvement given the bloated Muni-to-Treasury ratios we were already seeing (120%+ in the 10 year range). Friday feels like a warm-up lap to prepare for next week's race.

Muni Rates	Current Wk	Yld Change	Prior Wk	Muni to UST
2 Year	0.32	0.00	0.32	119%
5 Year	0.78	-0.01	0.79	122%
10 Year	1.82	-0.04	1.86	117%
30 Year	3.12	-0.04	3.16	117%

UST Rates

2 Year	0.27	-0.03	0.30
5 Year	0.64	-0.08	0.72
10 Year	1.55	-0.10	1.65
30 Year	2.66	-0.09	2.75

	Current Wk	Prior Wk
Weekly Municipal Supply (\$ Bln)		
Negotiated	\$5.24	n/a
Competitive	\$1.49	n/a
TOTAL	\$6.73	\$0.06

Municipal 30 Day Visible Supply (\$ Bln)	\$9.29	\$3.30
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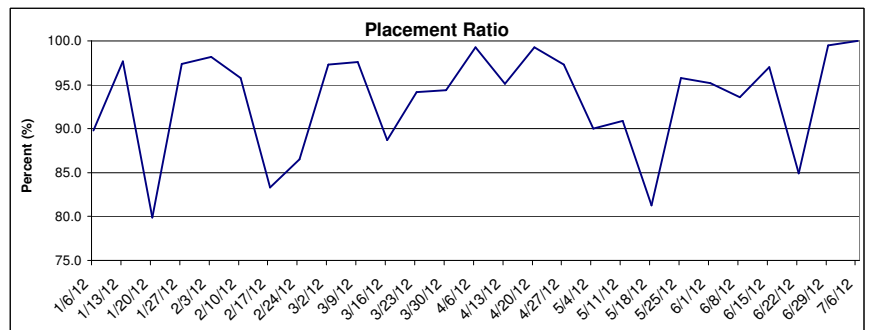
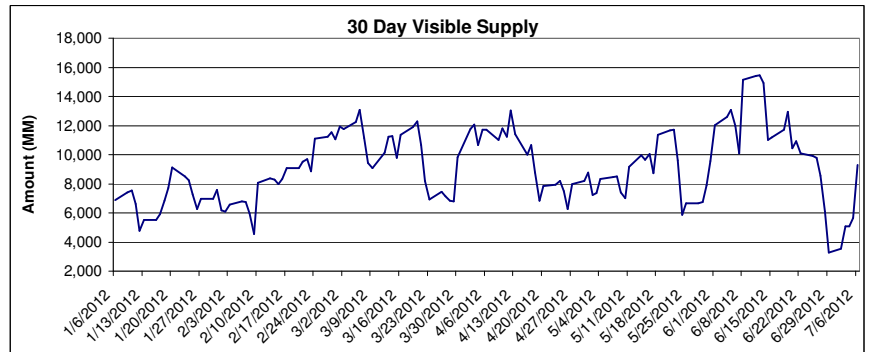
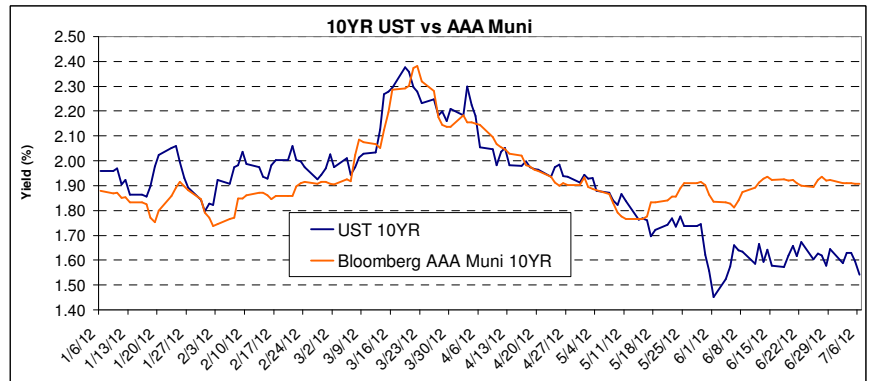
Bloomberg Muni PICK Offerings (\$ Bln)	\$9.52	\$11.02
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Muni Placement Ratio (New Issues)	100.00%	99.50%
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Bond Buyer 20 Municipal G.O. Index	3.94%	3.95%
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Select Economic Releases

Date	Event	Period	Survey	Prior
7/11	MBA Mortgage Applications	6-Jul	--	-6.7%
7/11	Minutes of FOMC Meeting			
7/12	Import Price Index (MoM)	JUN	-1.9%	-1.0%
7/12	Initial Jobless Claims	7-Jul	370K	374K
7/12	Continuing Claims	30-Jun	3255K	3306K
7/12	Bloomberg Consumer Comfort	8-Jul	--	-37.5
7/13	Producer Price Index (MoM)	JUN	-0.4%	-1.0%
7/13	PPI Ex Food & Energy (MoM)	JUN	0.2%	0.2%
7/13	U. of Michigan Confidence	JUL P	73.5	73.2



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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