

Trading Desk Commentary

Municipal bond fund flows offer one of the most telling gauges of the tax-exempt market's tone. The stat offers one of the purest measures of demand, given the greater liquidity and real-time nature of the mutual fund arena versus the broader bond market. Furthermore, fluctuations in the Muni bond market can be heavily influenced by US Treasuries movements, Muni-to-Treasury ratios (i.e. relative value), and an array of other conflicting variables. Fund flow data essentially boils down to the market saying: we like Munis right now or we don't. Unsurprisingly, 2012 has been characterized by strong inflows of cash into Municipal bond funds. In our opinion, the primary driver behind the phenomenon has been two-fold: 1) easy, quick access to the Municipal space as investors sought out haven asset classes, while 2) true Municipal bond supply was far outstripped by the ravenous demand. Last week felt like it potentially marked a critical shift in the "flight-to-quality" mindset. It looked like the US and European economic picture that plagued global markets were simultaneously receiving critical attention from their respective central banks. Risk assets (i.e. equities) immediately shot skyward and US Treasuries weakened dramatically. Yesterday, we saw another interesting side effect: a dramatic drop in Muni bond fund flows, as only \$265mln in new cash moved in to the fund sector according to Lipper. While still positive, this comes only a week after the same fund family posted a \$2.3 billion inflow. This is a dramatic difference between just 5 trading days. Perhaps most interestingly, the High Yield fund sector saw its first weekly outflow in six months. High Yield funds have been in favor by offering exposure to the "safer" fixed income markets while providing investors with an extra yield boost, but the week ending 9/19 brought this trend to a grinding halt.

What we have seen is the flip side of the optimism generated in the few days after the ECB and Fed unleashed new stimulus and bailout plans. Now, questions have started to seep in. Are their support packages enough? Will yet another round of stimulus really make a difference? If so, why have QE 1 & 2 failed to spark a stickier recovery? The excitement has given way to concern. Those that jumped on the "Risk On" trade last week paid for it this week. We continue to manage based on our longer-term outlook as opposed to reacting to the brief spurts. So many questions remain unanswered, and so many hurdles lay ahead for the world's biggest economies. We believe that quality assets will remain in vogue as new recovery challenges emerge in the US and elsewhere. We used the quick spike in Muni yields to buy bonds at discounted prices and have since ridden our long bias to outperformance over the past several days. We continue to view yieldier revenue sectors favorably in the Muni space as investors continue to place a premium on incremental yield. Our long duration bias and view of US debt markets remains intact. The Fed and ECB offered up a step in the right direction, but fell short of a permanent solution.

| Muni Rates | Current Wk | Yld Change | Prior Wk | Muni to UST |
|------------|------------|------------|----------|-------------|
| 2 Year | 0.29 | 0.00 | 0.29 | 112% |
| 5 Year | 0.69 | -0.06 | 0.75 | 103% |
| 10 Year | 1.79 | -0.14 | 1.93 | 102% |
| 30 Year | 2.95 | -0.11 | 3.06 | 100% |
| UST Rates | | | | |
| 2 Year | 0.26 | 0.01 | 0.25 | |
| 5 Year | 0.67 | -0.05 | 0.72 | |
| 10 Year | 1.76 | -0.11 | 1.87 | |
| 30 Year | 2.95 | -0.14 | 3.09 | |

| | Current Wk | Prior Wk |
|---|---------------|---------------|
| Weekly Municipal Supply (\$ Bln) | | |
| Negotiated | \$6.37 | \$7.64 |
| Competitive | \$1.31 | \$1.00 |
| TOTAL | \$7.68 | \$8.64 |

| | | |
|---|---------------|----------------|
| Municipal 30 Day Visible Supply (\$ Bln) | \$9.69 | \$10.78 |
|---|---------------|----------------|

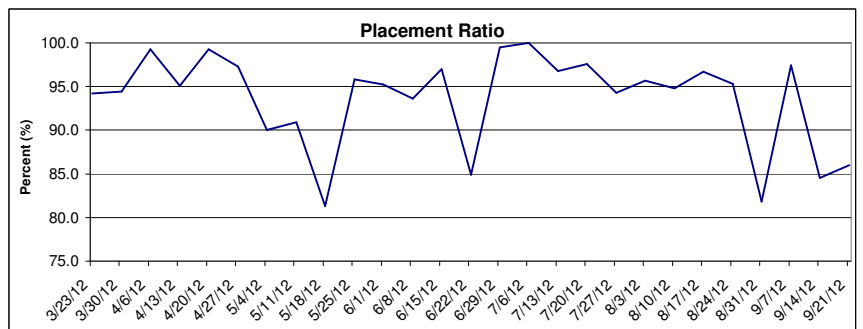
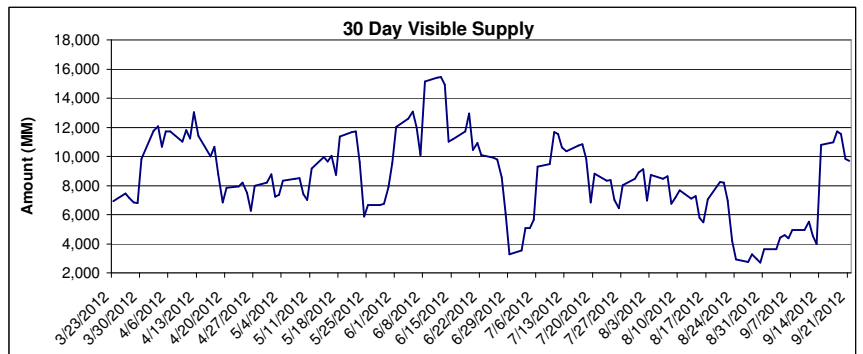
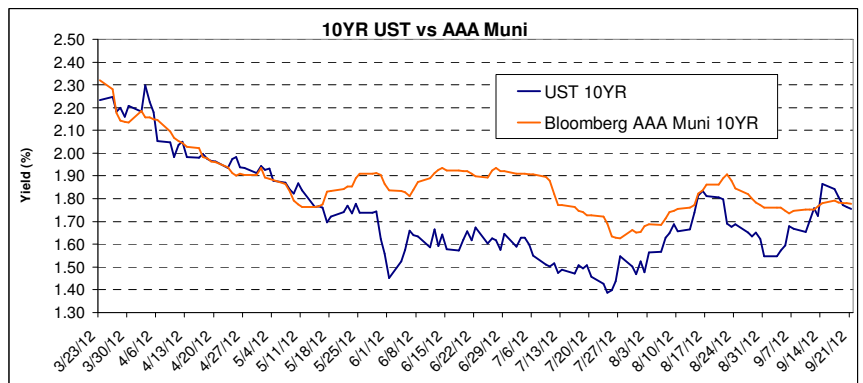
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| Bloomberg Muni PICK Offerings (\$ Bln) | \$9.80 | \$19.07 |
|---|---------------|----------------|

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|--|--------------|--------------|
| Muni Placement Ratio (New Issues) | 86.0% | 84.5% |
|--|--------------|--------------|

| | | |
|---|--------------|--------------|
| Bond Buyer 20 Municipal G.O. Index | 3.72% | 3.79% |
|---|--------------|--------------|

Select Economic Releases

| Date | Event | Period | Survey | Prior |
|------|---------------------------|--------|--------|-------|
| 9/25 | Consumer Confidence | Sep | 63.1 | 60.6 |
| 9/26 | MBA Mortgage Applications | 21-Sep | -- | -0.2% |
| 9/26 | New Home Sales | Aug | 380K | 372K |
| 9/27 | GDP QoQ (Annualized) | 2Q T | 1.7% | 1.7% |
| 9/27 | Core PCE QoQ | 2Q T | 1.80% | 1.80% |
| 9/27 | Durable Goods Orders | Aug | -4.7% | 4.2% |
| 9/27 | Initial Jobless Claims | 22-Sep | 375K | 382K |
| 9/27 | Pending Home Sales MoM | Aug | 0.0% | 2.4% |
| 9/28 | Personal Income | Aug | 0.2% | 0.3% |
| 9/28 | Personal Spending | Aug | 0.5% | 0.4% |
| 9/28 | U. of Michigan Confidence | Sep F | 79.0 | 79.2 |



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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