commentary on the markets *from*

THE MOORINGS GROUP

Custom fixed income portfolio management

Municipal Bond Market Update

January 15th, 2013

AAA municipal bond yields moved lower on a year-over-year basis in 2012 as follows:

	12/30/11	12/31/12
1 year maturity	.36%	.21%
3 year	.58%	.31%
5 year	.85%	.62%
7 year	1.19%	.95%
10 year	1.83%	1.53%
15 year	2.68%	2.06%
20 year	3.18%	2.36%
30 year	3.55%	2.82%

Source: Thomson Reuters Municipal Market Data (MMD)

2012 total returns reflect the decline in rates:

Barclays Managed Money Short/Intermediate Muni Index: **3.03%** (average maturity 5.73 years)
Barclays Quality Intermediate Muni Index: **3.84%** (average maturity 6.71 years)
Barclays Muni Bond Index: **6.78%** (average maturity 13.63 years)
Barclays High Yield Muni Index: **18.14%** (average maturity 20.23 years)
Source: Barclays Live

Simply put, long dated maturities outperformed short and intermediate maturities and high yield (lower quality issues) outperformed high quality.

Municipal bond funds continued to experience significant inflows throughout most of the year as the prospect for higher taxes loomed.

Concerns that the tax-exemption for municipal bond interest may be eliminated or capped by pending tax legislation triggered a mid-December back up in rates (approximately 20 bp in the 7 year maturity).

As it turned out, the year-end tax deal did not include any changes in the status of tax-exempt municipal bonds as "tax expenditures" were not addressed. It remains unclear if

ABOUT
The Moorings Group

The Moorings Group, an independent asset management firm, specializes in managing high-quality fixed income portfolios. The firm designs and manages custom portfolios that can help reduce the level of risk within a client's overall investment strategy and produce predictable levels of income. Established in 2003, The Moorings Group is based in Atlanta, Georgia, and is majority-owned by its investment professionals.

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President Obama will be able to procure more revenue in any debt ceiling and/or budget sequestration negotiations. The politics of the federal budget process make it difficult to reasonably predict specific outcomes. However, we still believe that ultimately state and local governments will make the case that taxpayers are the greatest beneficiary of the tax-exempt municipal bond interest. The greatest risk remains from "tax reform" which would seek an elimination of all or most tax expenditures and lower rates. It is hard to imagine that substantial tax reform can be accomplished in the current caustic political environment.

As the US Congress begins the process of reworking the across the board sequester budget cuts, state and local governments are starting their 2014 FYE budget process with a heightened uncertainty as to what program funding the federal government may decrease or eliminate. These reductions in funding combined with slow levels of growth in the overall economy could lead to greater volatility in creditworthiness. Uniquely, the creditworthiness of state and local governments tends to lag the overall economy and problems will not be uniform or universal.

While it is not impossible for the rating agencies to issue "Super Downgrades", i.e. multiple notch downgrades, it is probable that one notch downgrades will be delivered to those state and local governments that fail to act responsibly with cuts to services, reductions in employee benefits, and delays or cancellations of infrastructure projects. Debt service levels remain manageable and have improved in the last several years as the low interest rate environment has facilitated the refunding of municipal bond debt at record levels.

Employee pensions and other postemployment benefits (OPEB)* remain as a significant liability for most state and local governments. While these liabilities are long-term in nature, greater transparency and media attention could also add to credit volatility in 2013.

Interest rates are currently being driven principally by Federal Reserve policy. They have communicated that these current policies are not likely to change for several years. While they have removed specific dates for tightening policy, they have targeted 2 general economic benchmarks: unemployment and inflation. It is our expectation that the fixed income markets will move to higher rates before the Federal Reserve changes course. We do not expect that economic growth can accelerate with the strain of the current US political climate, unresolved economic disputes in Europe and global geo-political matters.

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***OPEB** is an accounting concept created by the GASB by pronouncements designed to speak to expenses that governmental entities may or may not be legally bound to pay, but consider as a moral obligation

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