

MUNICIPAL BOND MARKET NOTE

JANNEY FIXED INCOME STRATEGY

January 7, 2014



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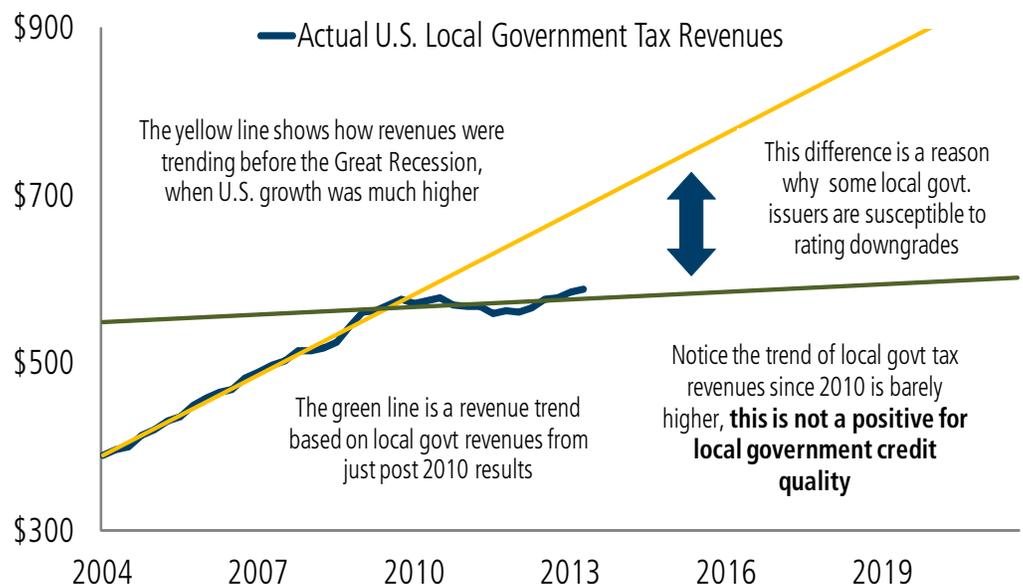
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Janney Outlook for U.S. Local Governments - Still "Cautious" - January 2014

Stagnating Revenues are not Keeping Pace with Expenditure Demands

- Our outlook for U.S. local governments remains "Cautious" even though the U.S. economy was mostly stronger in 2013.
- In 2014, we expect economic growth at a slower than historical pace, low state aid payments, questions surrounding housing, and budgetary uncertainty to continue to pressure local govts.
- The majority of local governments are and will remain highly rated. There are just over 7,000 local governments rated by Moody's with median ratings between Aa2-Aa3.
- Many are facing the post-2010 environment with open eyes. They have started to or already are budgeting conservatively, and not taking excessive risks.
- Other local governments have not adjusted to the new economic reality. They are still waiting for a return to the pre-2010 boom time when revenues (and spending) grew rapidly.
- The problem is that stagnating revenues are not keeping pace with expenditure demands.
- We estimate 10-20% of local government issuers have not adjusted to this new reality and are still susceptible to rating downgrades.
- Local government downgrades have outpaced upgrades by very wide margins in recent years. There were 608 downgrades in 2012 and 423 downgrades through 3Q2013. Downgrade ratios were 82% in 2012 and 81% in 2013.
- Local governments do not possess the budget flexibility states have, so this trend of downgrades outpacing upgrades is likely to continue.
- **INVESTOR RECOMMENDATION:** Our "Cautious" outlook does not mean investors should shun local governments. It simply means investors need to be increasingly conscious of the factors pressuring local governments and investors must carefully assess credits on an individual basis.

Risk Factor to Watch - Local Govt. Revenues Not Trending Close to Pre-2010 Levels



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