



STANDISH

Tax Sensitive Fixed Income

Monthly Municipal Market Update

Market Commentary

“Investment portfolios managed by Standish are largely immune from the impact of a US downgrade”

At the time of writing this piece, the US Government had yet to raise its debt ceiling. As a result, both Moody's and S&P had placed their Aaa/AAA ratings for the US Government on credit watch for a potential ratings downgrade. Furthermore, S&P is on record that even if the debt ceiling is raised, it could still downgrade the Federal Government if it fails to enact a credible plan to reduce future deficits. A failure by the US Government to address the long-term structural imbalances or raise the debt ceiling could cause problems for certain municipal credits.

Both agencies placed their ratings of municipal bonds that are tied directly to the US Government on negative credit watch including pre-refunded bonds. Debt service for pre-refunded bonds is paid by escrowed US Treasury bonds. A Federal default could cause delays in the payment of the debt service on the US Treasury bonds thereby leading to a default on the debt service on the pre-refunded bonds. Any such default though would eventually be cured once the debt limit is increased or the Federal Government receives sufficient tax revenues. In addition to municipal bonds whose ratings are tied directly to the US, Moody's has also placed the AAA ratings of several states on credit watch over concern of a decline in economic activity in response to a US downgrade. In our view, even though state governments receive approximately 30% of their revenues* from the Federal Government, they do have broad revenue sources and sufficient liquidity to draw upon leading to minimal default risk.

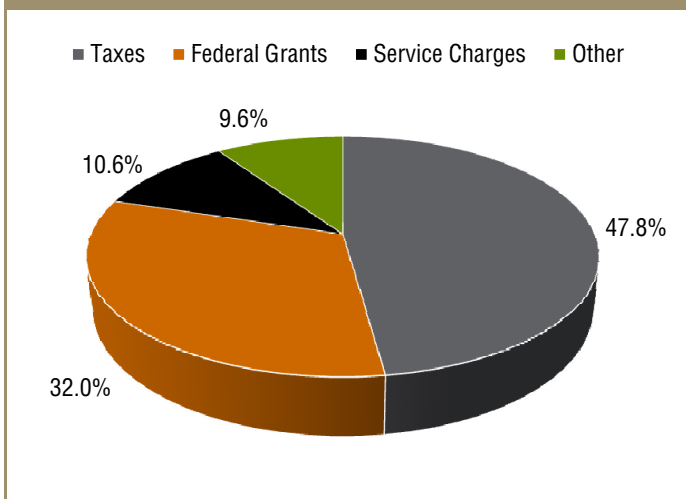
Investment portfolios managed by Standish are largely immune from the impact of a US downgrade. Standish typically maintains an underweight to both pre-refunded bonds and state general obligation issues due to their low yields. Instead we overweight exposures in client portfolios to attractive yielding water and electric utility bonds. These essential service bonds derive their revenues from sales and virtually none from the Federal Government. Additionally, another sector we overweight is special tax bonds. These state and local issues are backed by specific taxes or fees and are largely insulated from a federal government default. Also, hospital bonds we have purchased for our clients are issued by healthcare providers that have strong competitive positions, solid operating margins, and liquid balance sheets. These strong features help offset any delay in federal transfer payments for elderly or indigent care under the Medicare and Medicaid programs. Overall, we believe the risk posed by a US downgrade has been effectively managed by Standish commitments to municipal bonds possessing strong credit characteristics and attractive yields.

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*Source: US Census Bureau: State Government Finances Summary: 2009. Published January 2011

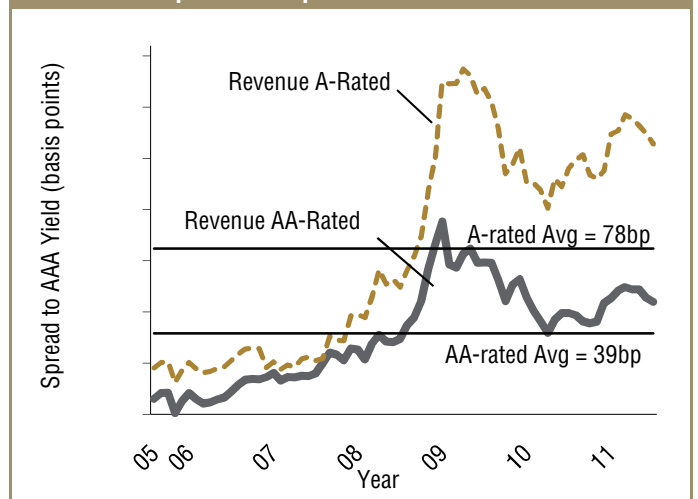
Charts of the Month

Source of State Government Revenue: 2009



Source: U.S. Census Bureau, 2009 Annual Survey of State Government Finances

A-rated Municipal Credit Spreads Attractive



Source: Barclays Capital, 10-year maturity revenue bonds

Credit Observations

“The State’s economy, which greatly underperformed the national economy between 2001 and 2009, has rebounded with the national recovery. Employment growth in the State has recently outpaced that of US, with year over year growth of 1.4% in State versus 1.0% between June, 2010 and June, 2011”

Credit in the Spotlight – Michigan State Building Authority*

In July the Michigan State Building Authority issued \$646 million of revenue bonds almost exclusively for refunding purposes. The Bonds are rated Aa3/A+/A+ (all stable outlooks) by Moody’s, S&P and Fitch, and are secured by annual payments made to the Authority by the State of Michigan. The Authority is a public agency that is responsible for the acquisition, construction and maintenance of the State’s public buildings. The State’s payments to the Authority for debt service represent rental payments for use of the buildings financed by the Bonds. The payments are appropriated annually by the State’s legislature. Under the terms of the lease, the Governor is required to include the amounts necessary to make the payments and the State’s legislature is contractually obligated to appropriate the monies in order to make the rental payments pledged for debt service on the Bonds. The leases securing the State’s payments extend beyond the final maturity date of the Bonds. The State’s economy, which greatly underperformed the national economy between 2001 and 2009, has rebounded with the national recovery. Employment growth in the State has recently outpaced that of US, with year over year growth of 1.4% in State versus 1.0% between June, 2010 and June, 2011. (Source: Bureau of Labor Statistics, US Department of Labor). Nevertheless, the highly concentrated nature of the State economy’s is a credit concern, as it the narrow, though positive, financial position of the State’s general fund. Credit strengths include low debt burden and conservative budgeting practices. The State’s pensions are adequately funded at 79%. The Bonds were attractively priced with yields on the 10 year maturity approximately 134 basis above the MMD AAA municipal bond scale.

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Other Credit Highlights: California Budget Passes Resulting in S&P Rating Outlook Change to Stable

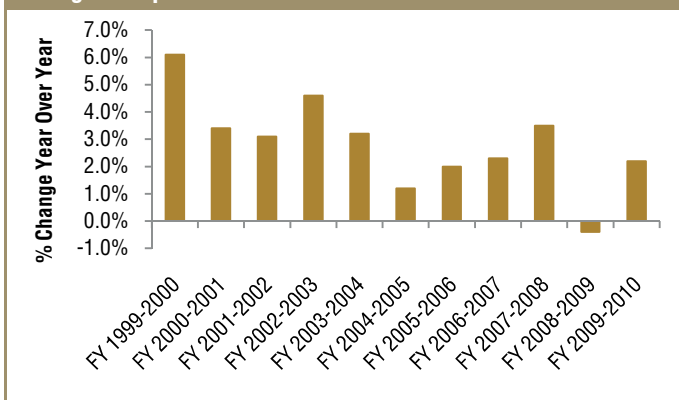
California passed its fiscal 2012 budget on June 30, 2011 using a combination of spending cuts, optimistic revenue assumptions, and accounting maneuvers. To be sure, spending reductions comprised the largest component of the budget gap closure. With approximately \$15 billion in total cuts, Standard and Poor’s reports that California’s general fund spending, as a percentage of statewide personal income, is at its lowest levels since 1973. Revenues continue to outperform, helping to relax fiscal pressure, though the budget does run the risk that continued outperformance is not sustainable. Additional spending cuts will be automatically triggered if the lofty revenue projections are not met. Accounting shifts, including the redirection of local property tax revenues from redevelopment agencies to elementary schools, round out the remainder of the solutions. While not entirely structurally balanced, the budget is an improvement over prior years and its early passage sufficiently helps the state avoid liquidity challenges that have hurt the state. Standard and Poor’s has rewarded California by revising their outlook to stable from negative while affirming their “A-” rating.

* Source: Unless stated otherwise the source for information on the bonds is the preliminary official statement for the State Building Authority, State of Michigan 2011 Revenue and Revenue Refunding Bonds dated July 5, 2011

Jeffrey B. Burger, Senior Analyst

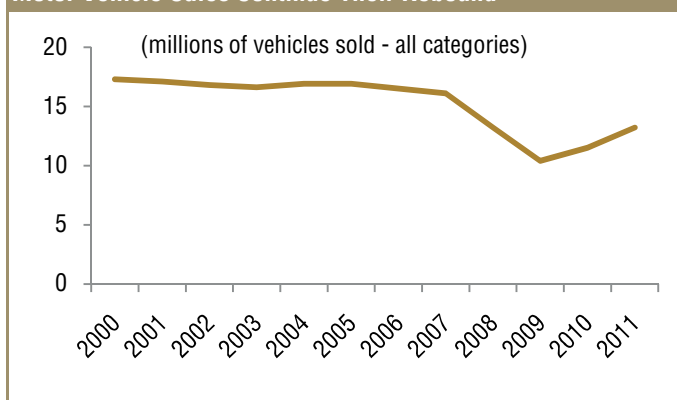
Credit Charts of the Month

Michigan Disposable Income Increases



Source: Research Seminar in Quantitative Economics, University of Michigan, and Administration Forecast, May 2011

Motor Vehicle Sales Continue Their Rebound



Source: Bureau of Economic Analysis, U.S. Department of Commerce, and Administration Forecast, May 2011

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