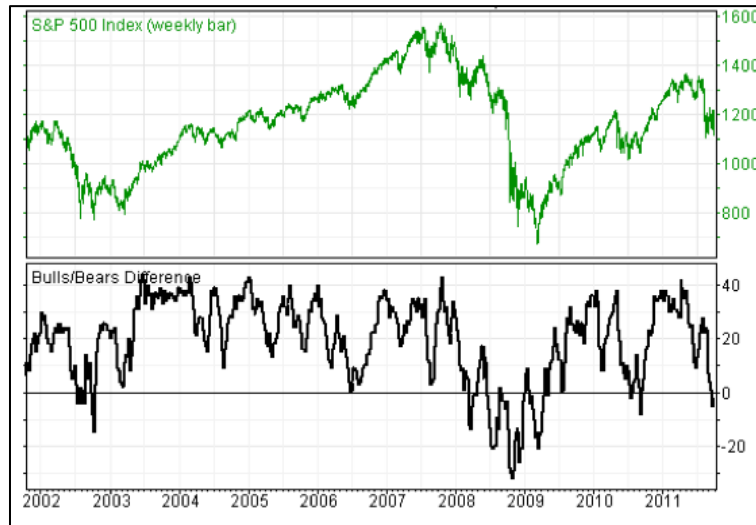


Market Recap

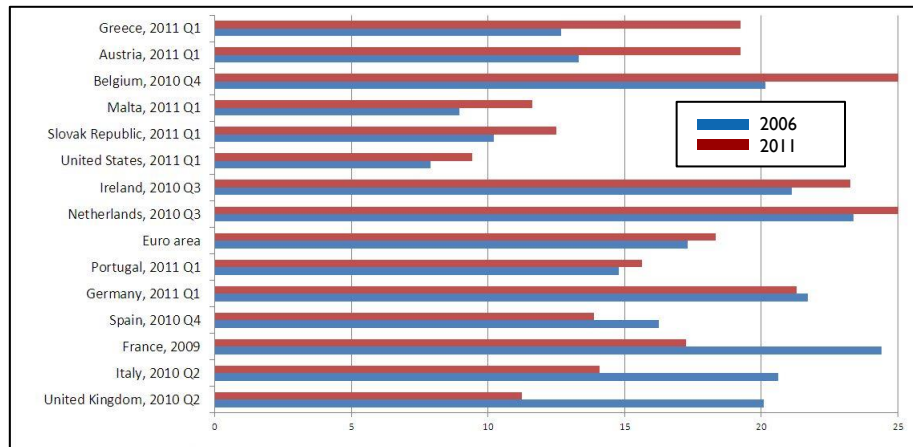
Ratio of Bullish to Bearish Advisors



Source: Factset

With the recent pressure on the market, investment sentiment has turned decidedly negative. According to the most recently-released data, bearish (negative) investment advisors have outnumbered bullish (positive) advisors for the past three weeks. The current reading represents an extremely pessimistic view, as there have only been a few occasions in the past ten years when total bears have outnumbered bulls. The ratio is a classic contrarian indicator. Historically when you see readings at these levels, the end of a correction or at least the formation of a market bottom has been signaled. This provides some hope of a possible recovery. We saw similar readings at the end of August 2010; after about three and a half months of sideways trading, the market moved 15% higher by the end of the year.

European and U.S. Bank Leverage

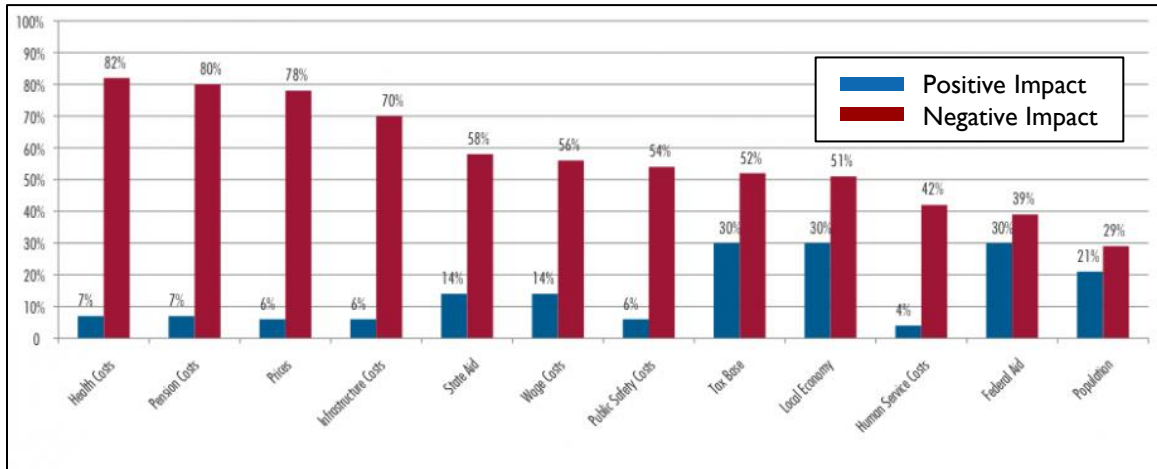


Source: International Monetary Fund

One of the key issues that has come to light with the European Sovereign debt crisis has been the excessive use of leverage by European banks. If bank liabilities are subtracted from bank assets and the result is negative, the bank is technically insolvent. A highly-levered bank cannot afford to suffer deterioration of its assets (e.g., as a result of a recession or through excessive loan defaults); shrinkage of a few percentage points may result in insolvency. German, French, and Belgian banks (on average) have much higher leverage than US banks (which presumably learned their lesson in 2008). Of further concern is the high correlation existing between overly-leveraged banks and the health of their sovereigns as banks.

Market Recap

Impact of Factors on 2011 Municipal Budgets



Source: National League of Cities

Projected Budget Impacts on 2012 GDP

	Cost (\$bil)	GDP Impact (\$bil)	% of GDP
Payroll Taxes	-110	-74	-0.5%
Unemployment Taxes	-50	-45	-0.3%
Accelerated Depreciation	-25	0	0.0%
State/Local Transfers	-50	-33	-0.2%
Infrastructure, etc.	-75	-75	-0.5%
August Debt Deal	-40	-40	-0.3%
Total	-350	-267	-1.8%

Source: JP Morgan

Last week, the Jefferson County, AL, Commission avoided a high-profile bankruptcy filing by agreeing to terms with creditors to restructure \$3 billion in defaulted sewer debt. The settlement highlights the reality that bankruptcy is seldom the preferred resolution for even the most distressed municipality. There have been just 24 bankruptcy filings between 2007 and 2011 in a market of over 87,000 issuers. A municipality's decision to file bankruptcy must be weighed against its negative consequences (credibility, cost, and access to credit markets). With the economic recovery faltering, municipalities are feeling increasing strain on their finances. A recent survey of 272 leading cities reveals significant negative pressures on these municipalities.

Developments in recent weeks have challenged the view of sustained economic growth. Current one-year forecasts for GDP growth have fallen to around 2%. There are expectations for significant fiscal tightening next year, as it is unlikely that payroll tax cuts or emergency unemployment benefits will be extended beyond year-end. Current forecasts estimate the total fiscal drag from the current budget to be around -1.8% of GDP. Fortunately, the forces typically present during a recession (rising interest rates and tightening credit conditions with increased credit demand) are absent today. The greater concern is the lasting damage of a slowdown and unemployment for an extended period of time. Persistent underutilized resources will weigh on future growth, limit budget improvement, and lead to potential disinflation.

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