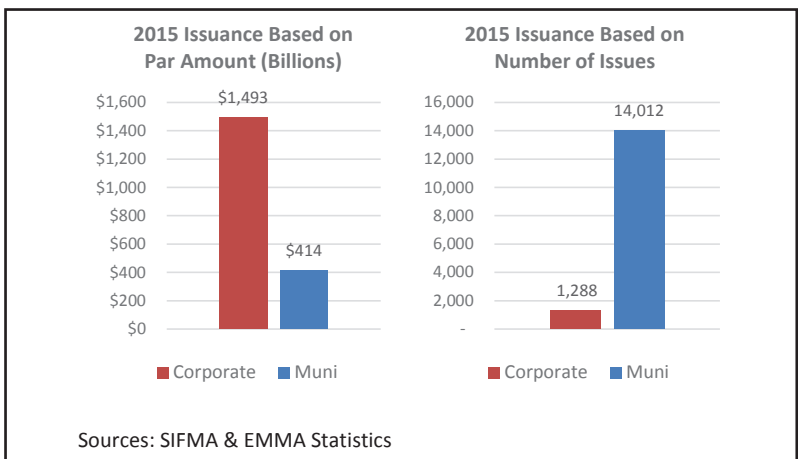
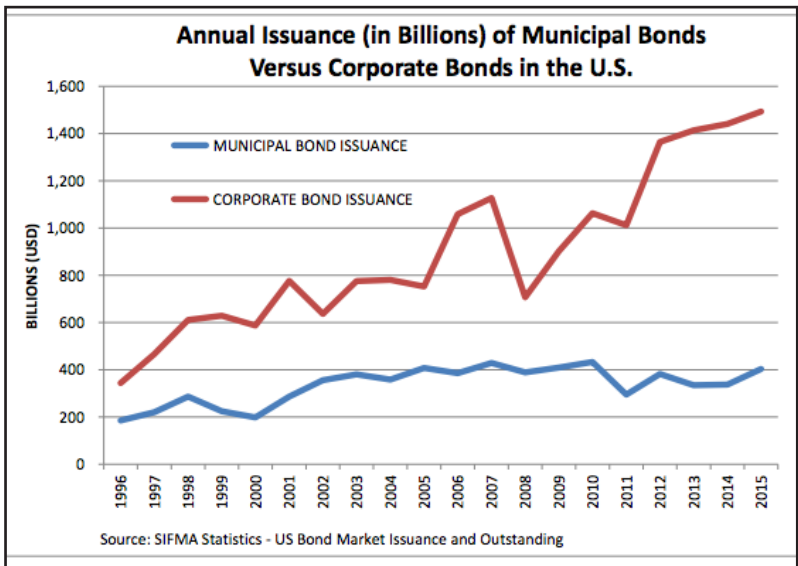


More Issues Require More Diligence

We know it's impossible to generalize when talking about "the bond market". Yet, it's easy to fall into that trap. The SEC quote Betsy pointed out in her article reminds us of how complex and varied the municipal bond market is as compared to the corporate bond market. The first chart is total issuance for corporate bonds versus municipal bonds over the last 20 years, showing us that the gap between corporate and municipal debt has sharply risen in recent years. The second picture illustrates one of the reasons why dealing with municipal bonds is more like sifting through the proverbial "needle in the haystack". In 2015, only 1,288 corporate issues were underwritten, totaling nearly \$1.5 trillion. In muni-land, 14,012 issues came to market, accounting for only \$414 billion in par value, that's more than 10 times the number of corporate issues! These are just a couple of things to keep in mind when considering the best ways to stay on top of this vast and diverse marketplace.

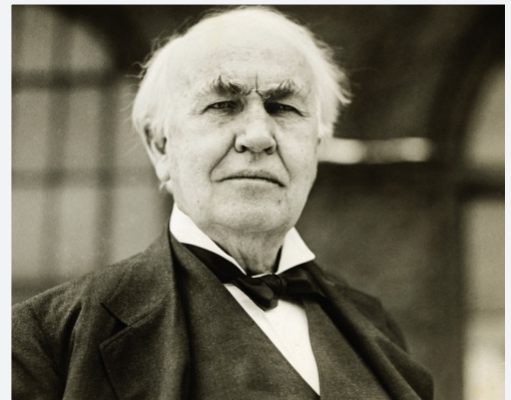


In This Issue

- Another reason munis are not like corporates.
- Credit Corner: Vigilance is job one.
- CFI Professionals: In The News
- Fish Scales – CFI Proprietary Market Snapshot

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"The three great essentials to achieve anything worthwhile are, first, hard work; second, stick-to-itiveness; third, common sense."
- Thomas A. Edison



Credit Corner - Vigilance is Job One

If ever asked what I think the mantra of an outstanding credit analyst should be, my answer would be “eternal vigilance”. We may not be able to control of the number of investment options available in the marketplace at any given time and we most certainly can’t control interest rates. However, one can, and

By Betsy Shelton, Director of Research / Sr. Portfolio Manager.

should, be ever aware of the credit quality of each of one’s portfolio holdings. Despite the great advances in technology in recent years, as well as the presence of numerous vendors offering “news scrubbing”, getting into the “down and dirty” of local communities continues to require constant diligence if
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FISH SCALES

			Scales for California names only						
NATIONAL AAA RATED**		JAN	AA G.O.	A-rated COPs	Pre-Refunded	Non - Rated*	USTN	AA Txbi	Muni
0.40		2017	0.45	0.64	0.40	0.76	0.45		+38
0.66		2018	0.70	0.94	0.65	1.18	0.78		+43
0.78		2019	0.90	1.16	0.82	1.46	0.97		+53
0.89		2020	1.05	1.34	0.98	1.70	1.20		+59
1.00		2021	1.20	1.50	1.11	1.88	1.33		+67
1.12		2022	1.30	1.66		2.06	1.53		+78
1.28		2023	1.50	1.83		2.26	1.67		+86
1.45		2024	1.70	2.03		2.47	1.73		+99
1.60		2025	1.90	2.21		2.65	1.87		+105
1.71		2026	2.08	2.38		2.80	1.92		+112
1.81		2027	2.25	2.50		2.92			
1.90		2028	2.35	2.63		3.01			
1.99		2029	2.46	2.69		3.12			
2.08		2030	2.55	2.81		3.20			
2.16		2031	2.65	2.93		3.28	2.18		+149
2.48		2036	2.80	3.30		3.58	2.35		+170
2.69		2041	3.01	3.59		3.78	2.62		+155
2.75		2046	3.12	3.65		3.96	2.74		+152

* National Scales from MMD
**Proxy for Non-Rated Paper

January 31, 2016
AS OF DATE



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one is to stay one step ahead of headline risk. At CFI, we believe that “kicking the dirt” will always be an integral part of municipal credit analysis. Good times make it easy to forget past struggles and the lessons learned therein. Improving revenues have once again strengthened most local government coffers and many services previously canceled or scaled back have been reinstated with vigor. We all want to “let the good times roll” but it is done best in the context of the knowledge and wisdom gained from previous challenges endured during the not-so good times. It is in this context that I share with our readers two situations in the hopes that they will remind us all to keep one’s credit antennas up and alert.

The first case has to do with the City of Beaumont, California, uncovered last summer when CFI was reviewing a prospective client’s portfolio that held bonds issued by the City. The City has a long history of favoritism and cronyism so we were not surprised to find during the course of our discovery process that Beaumont had significant irregularities in their accounting system. The situation was so bad that the city fathers refused to certify the 2014 financial statements because of allegations of forgery and a recent FBI raid on several city officials’ offices and residences. After over 20 years of service, the City’s Director of Finance resigned on May 1, 2015. However, news of the City’s financial mismanagement and the results of a state investigation which showed “widespread deficiencies” in the City’s fiscal controls did not appear on the new wires until the week of November 6th, a full 6 months after things began to unravel at the local level. The State found that “75 out of 79 internal control elements were determined to be inadequate.” While the City is making efforts to improve its finances, including bringing in an outside consultant to restructure its debt, correcting Beaumont’s financial problems will take time. We would be remiss if we did not remind investors whenever eyeing an opportunity to lock in higher yields, the motive should be

driven by a market imbalance and not poor credit fundamentals.

A more recent instance involves the Port of Oakland whose outstanding senior debt is currently rated A3, A, and A+ by Moody’s, Standard & Poor’s, and Fitch, respectively. On Monday, February 1st the Port lost its second largest terminal operator and largest unsecured creditor when Outer Harbor Terminal LLC (previously known as Port America) declared Chapter 11 bankruptcy protection after just 6 years into a 50-year lease. OHT cited operating losses at the Port and difficulty in meeting its obligation during the winding down of its operations. In 2015 OHT accounted for nearly \$38 million or 32% of the Port’s maritime revenues. Although the Port also has revenues from its operation of Oakland Airport and commercial real estate activities, slightly half of the Port’s overall revenues are derived from its maritime activities. So you can see this is no small “bump in the road” when it comes to the uncertain impact on debt service coverage and potential future rating downgrades. Port officials estimate the first full year financial impact of OHT’s actions will result in a loss of between \$10 and \$15 million. While the Port expects the lion’s share of cargo coming into Oakland through OHT will be retained through re-allocation to other terminals carriers and the quick re-letting of OHT’s terminal facilities, only time will tell the true impact of the situation and outcome on the Port’s financial condition. What is important to note here is that as of this writing (February 5th) we have been unable to find any notice of material event or any other filings on the MSRB’s EMMA system denoting the OHT event. Although some may say that regulations do not require any filing actions, we are surprised at the lack of a simple “heads-up” in light of the numerous news articles and rating agencies’ comments.

While we have cited only two examples here, there are certainly many more circumstances throughout the country where issuer events have

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CFI's Team – Giving back to the Community

Our own Sharmi Chakraborty, CFI's Chief Operations Officer, gives of her time at Hope in Life Foundation (www.hopeinlifefoundation.org) as a Director and Events Manager. She recently emceed the 2nd Annual Fundraiser luncheon held at a popular Indian restaurant in Orange County. This lovely event featured a fusion of music, dance and fashion with gorgeous models from both LA and New York. Yes, Sharmi was one of the models, in case you were wondering. As Mistress of Ceremonies, she beautifully articulated the organization's vision and mission, which is clearly near and dear to her heart.

Hope in Life Foundation's mission is to end domestic violence via training and education. Their long term vision is to move towards a world free of gender



Mistress of Ceremonies Sharmistha Chakraborty (left) with Hope in Life Foundation Founder & CEO, Rupsi Burman

discrimination and abuse, creating a world where women and children will lead extraordinary lives and make positive impacts in the communities they live in. We agree that Sharmi is certainly making an impact. Nice work dear friend!

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had a material impact on investor portfolios. Regrettably these instances are virtually unknown to the individual investor as well as to many who claim to be market professionals. The fact that news does not always travel fast within the municipal market can be attributed to the surprisingly large universe of municipal issues and the disclosure inefficiencies we have discussed in previous articles. According to a report issued by the SEC, "Although it is less than half the size of the corporate bond market in terms of total principal outstanding, the municipal securities market is estimated to have more than 1.5 million different types (i.e. CUSIPS numbers) of bonds, which is 20 times the number of corporate bond types."

Clearly, doing one's due diligence at the time of purchase is simply not enough. Nor is an annual review sufficient. The truth is credit monitoring must be done regularly and consistently on each security as long as one holds it. It has been our experience that many investors are overly concerned about market risk and fail to recognize, and take steps to counter, potential

credit risks. Generally speaking, individual investors do not have the inclination, time, or the resources to continuously monitor their holdings. Without sophisticated municipal market professionals like CFI's team of experts vigilantly "watching the store", it is easy to see how individual investors can miss important credit news.

So as a new year begins, it is essential that all investors, both individual and professional, resolve to be ever diligent in knowing the credit status of their holdings. Or to paraphrase the words of that ubiquitous Capital One ad: What's in your portfolio? Do you truly know?

For more information visit
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 or call Susan Munson at 949-296-3970 or
susan@charlesfishinvestments.com
 to schedule a private consultation.