Opportunities Abound!

The following excerpt from the Chairman's Letter provides great questions for any investor, and especially a municipal bond investor. If the answers you get are still fuzzy, we are happy to clear things up a bit. Call for a no obligation consultation.

By Charles "Skip" Fish, CEO and CIO

Just as the young infantry officer is taught that there is always, always, more that can be done to protect their troops and increase the probability of successfully completing the mission, there is always more that can be done to improve a portfolio. If you know someone whose municipal bond portfolio is being managed by someone other than CFI, they should be asking:

1. If, after seven years of market recovery, the U.S. economy should backslide, interest rates would come under renewed downward pressure. Is my portfolio too heavily weighted in the short end?
2. Is too great a portion of my portfolio exposed to harmful, rather than beneficial, call options?
3. Do I own any declining credits that should be swapped for more stable ones?
4. Can I increase my yield by selling bonds at a loss that can be made up in short order by purchasing a higher yielding item?
5. Is my portfolio manager working to improve the return and safety of my portfolio, or are they stuck like deer in the headlights?

There is no substitute for vigilance and hard work. Uncertainty is not to be feared. ***Opportunities are all around!***

Buying or selling munis? Consider the risks and opportunities of interest rate movement.

We recently posted an article on our website about municipal bonds and interest rates published by the MSRB Education Center. It is basic analysis to help investors consider the risks associated with changes in interest rates. If you are interested in discussing or learning more, give us a call.

Download pdf

In This Issue

Our Mission

CFI is dedicated to the task of securing for each individual account the best possible after-tax performance net of fees. We accomplish this by actively managing tailored portfolios in strict adherence to the strategic objectives of each client. It is our responsibility to employ the most suitable fixed income assets and strategies in a manner most effective for every account. It is our duty to devote the resources, intensity and vigilance necessary to insure all clients consistent superior results.

"The general who can easily adapt will know how to employ his forces.
The general who does not, will not be able to take advantage of opportunities."

–Sun Tzu, *The Art of War*

We ♥ Annie!

It's been a little over a year since Anh "Annie" Tran joined the CFI team as Portfolio Analyst. She has proven to be extraordinarily competent on multiple fronts and we see a bright future ahead. In addition to keeping up with Skip and Betsy on the desk (no small feat!), she passed CFA Level 3 thus achieving the highly regarded (and scary difficult) designation of Chartered Financial Analyst. We are pleased to announce her well-deserved promotion to Portfolio Manager and are confident all of our CFI clients will soon understand the value she is adding to their portfolios and our organization. ***Congratulations Annie!***

To read more about Annie and other members of the CFI team visit ***charlesfishinvestments.com/team***

FISH SCALES

		Scales for California names only					
NATIONAL AAA RATED**	AUG	AA G.O.	A-rated COPs	Pre-Refunded	Non - Rated*	USTN	AA Txbl Muni
0.23	2016	0.25	0.42	0.26	0.93	0.31	+35
0.55	2017	0.56	0.84	0.58	1.41	0.63	+50
0.79	2018	0.84	1.13	0.81	1.82	0.91	+65
1.02	2019	1.09	1.44	1.05	2.19	1.19	+78
1.27	**2020**	**1.37**	**1.73**	**1.28**	**2.50**	**1.36**	**+80**
1.46	2021	1.56	1.99		2.76	1.60	+88
1.65	2022	1.79	2.22		3.00	1.74	+97
1.81	2023	1.98	2.42		3.17	1.86	+107
1.91	2024	2.13	2.57		3.29	1.99	+112
2.03	**2025**	**2.27**	**2.71**		**3.43**	**2.04**	**+119**
2.15	2026	2.44	2.89		3.55		
2.25	2027	2.56	3.02		3.70		
2.34	2028	2.68	3.13		3.85		
2.43	2029	2.81	3.24		3.92		
2.52	**2030**	**2.90**	**3.34**		**4.02**	**2.30**	**+160**
2.80	**2035**	**3.18**	**3.58**		**4.21**	**2.52**	**+180**
2.97	**2040**	**3.37**	**3.74**		**4.34**	**2.78**	**+181**
3.05	**2045**	**3.44**	**3.83**		**4.41**	**2.86**	**+178**

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

September 30, 2015
AS OF DATE

Credit Corner

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

All Eyes on Puerto Rico

Editors Note: Even if one does not own Puerto Rico bonds, it's possible that the legal and political outcomes will impact municipal bond credits across the board. For this reason, we believe anyone investing in municipal bonds will have some interest in the continuing saga, where each day brings new discussions, proposals and continued uncertainty. Stay tuned!

It is always tempting to jump into the fray when a crisis begins to unfold. However, the information one receives during such a chaotic time is often incomplete, distorted, and sometimes simply not true. For this reason we have been reluctant to make any comments about Puerto Rico's potential default until the dust settled a bit. That's not to say that there are no longer any dramatic, and often overblown, headlines about the situation; however, it does appear that cooler heads have begun to prevail and workable solutions are being put forth to address the nearly $71 billion in debt issued by the Commonwealth and its quasi-public corporations (PREPA, PRASA, HTA, etc.). After culling through hundreds of news headlines, credit analyses, and opinion papers, we think it is now a good time to share our thoughts regarding some of the things that have transpired recently. These can be separated into three categories: 1) measures enacted or proposed by the current governor's office, 2) forbearance agreements made to date by the bondholders, and 3) potential legislative actions that could be taken by Congress.

At last count, close to 50% of the headline news that CFI's research department receives and reviews daily from a variety of sources can be attributed to the ongoing challenges and dilemmas facing the Commonwealth and its bondholders. It will, of course, take time to vet those options to determine which are realistic, practical, and appropriate. The Island's economy has been suffering from recessionary slowdown and subsequent anemic growth since 2006. In addition, it has been more highly impacted by ballooning Medicare charges due to a poverty level that is twice that of the poorest American state, and made less competitive than its Caribbean island neighbors due to the Jones Act .

Pundits line up on both sides of the aisle when it comes to evaluating the government's efforts to put its fiscal house in order. We have often said that nothing happens in a vacuum and Puerto Rico's current financial crisis is no exception. Political cronyism, failure to act in a timely fashion, bad tax policies, and an overall mismanagement of both funding and facilities have converged into today's fiscal volcano. On September 9th the Governor unveiled his Fiscal Adjustment Plan as his proposed roadmap for achieving fiscal balance and a return to economic growth. Unfortunately, in order to work, the plan will require five years of bruising reform. Not only is it questionable that Puerto Ricans have the fortitude for such austerity, many investors and investment bankers are wary of the Governor's commitment due to his history of playing both the blame game and the shell game when it comes to the available sources of revenue. Specifically, the Governor wants to reallocate taxes away from both the Puerto Rico Sales Tax Finance Corporation ("COFINA") and the Commonwealth's Highway and Transportation Authority ("HTA"), which would be in clear violation of the respective trust indentures. His defense in doing so? That further budget cuts would harm the delivery of services, a claim which many find questionable in that nearly half the population are public employees who annually enjoy 63 days of paid time off! The Governor has proposed using petroleum and gasoline taxes, which have been legally pledged to the highway fund, to pay upcoming debt service on the Commonwealth's general obligation debt. In S & P's opinion, doing so would make all of tax-backed debt highly vulnerable to default, thereby prompting the rating agency to lower its rating on these types of bonds to CC.

Hoping to garner support for his plan, the Governor has proposed the creation of an external control board. However, such a board would have to be created by Congress and would need some truly serious teeth in order to be successful. Most parties agree on the need for some outside intervention similar to the Municipal Assistance Corporation ("MAC") that led New York City out of its fiscal crisis in the 1970's or the 1995 federal intervention into the finances of the District of Columbia. The creation of an oversight board has been a talking point but the actual enactment of such is considered to be a long shot at this time.

Regrettably the Commonwealth has squandered its credibility on a variety of fronts which makes it extremely challenging to negotiate forbearance agreements with bondholders. The plan for growth set forth in the Fiscal Adjustment Plan is predicated on achieving investor

(continued on page 4)

(continued from page 3)

cooperation in the restructuring of $47 billion in outstanding indebtedness – no small feat for even the most malleable of creditors! Current estimates are that the Commonwealth only has $5 billion of the needed $18 billion required to service its debt in forthcoming months and this amount does not include debt service due on its electric and water utility obligations. For over a year PREPA has been in extended forbearance negotiations with creditors in order to restructure $8.6 billion of the Authority's outstanding bonds. The most recent pending agreement requires bondholders to consent to both interest rate cuts and extended maturity schedules. Like its stateside counterparts, Puerto Rico has issued many types of bonds through multiple agencies which have pledged repayment from a variety of different sources. Given the diversity of legal claims by bondholders, it is highly unlikely that creditors will be open to uniform agreements which makes achieving universal acceptance extremely challenging.

Complicating, as well as prolonging, the situation is Congress's inability to decide what, if any, action it should be taking to assist the Commonwealth. A 1984 amendment to the federal bankruptcy code, either accidentally or arbitrarily, defined Puerto Rico as a state in all aspects EXCEPT when it comes to the ability to file Chapter 9 for itself or its agencies, in which case it is treated as if was still a territory requiring Congressional approval. Without the bankruptcy option enjoyed by almost all U.S. municipalities, the Commonwealth's many agencies are forced to go directly to bondholders for relief, which can be tenuous at best. Earlier bills in both the House and Senate, including the Senate's September 29th request for more information before proceeding with any potential bankruptcy protection discussion, confirms the opinion of many that even Chapter 9 will do little to resolve Puerto Rico's serious liquidity and long-term structural problems. Any federal intervention, should it happen, will likely to be too little too late for the cash-strapped island which faces a $205 million deficit by December of this year, and which balloons to over $500 million by June 2016.

Clearly trouble has been brewing in Puerto Rico for a long time and bondholders have had ample time to exit this deteriorating situation. Those remaining bondholders fall into four camps: 1) those in denial of the seriousness of the situation, 2) vulture investors who snatched up bonds at distressed prices and are looking to make a quick buck on any market rebound, 3) bond insurers hoping to mitigate the impact to their liabilities or 4) those that can be classified as the proverbial deer caught in the headlights, unable take action.

If all this news has your head swimming, you are not alone. Like trying herd cats, it is virtually impossible to predict the outcome of this crisis at this time. The devil will be in details as the multitude of participants seek to find acceptable resolutions to this monumental crisis. At present the only sure thing is the very high probability of messy and protracted litigations given the wide range of individuals and institutions with divergent interests. We invite you to stay tuned for periodic updates as they unfold over the coming months.

[1] Also known as The Merchant Marine Act of 1920, this act requires the transport of goods between U.S. Ports be carried by U.S. built and U.S owned ships with U.S. crews, resulting in the lack of foreign competition and subsequently higher priced goods.

For more information visit

CharlesFishInvestments.com

or call Susan Munson at 949-296-3970 or

susan@charlesfishinvestments.com

to schedule a private consultation.