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Letter from the Chairman…

"The play is the thing wherein I'll catch the conscience of the king."
Shakespeare's Hamlet, Act II, Scene 2

It seems reasonable to expect that the great tasks before us (infrastructure, the environment, education, immigration, etc.) are to take a back seat to the play entitled Impeachment Proceedings. So be it. At any rate, the deadlocked Congress seems incapable of passing any meaningful legislation addressing any of our many challenges.

If fiscal policy is on a hold, we must look to monetary policy for direction. We do not believe that the economy is so terrific that the Fed need not do anything. On the contrary, in light of the gathering global clouds, they must be prepared to act. The data on which they depend is rarely only black or white. They must be guided by where the available information leans and then strive to do no harm. This invariably leads to a strategy of incremental steps. This is exactly what they did in July and September. In the presence of any truly negative news between now and October 30th, they'll cut again. At present, the street is 70/30 in favor of another cut.

In going forward, there are a few things I'd like to point out:

1. New issues of triple AAA municipals now offer little more yield than the after-tax yields on U.S. Treasury securities. To find a meaningful spread, one must be willing to buy bonds maturing in ten years or longer.

2. Debt levels everywhere are growing exponentially. Globally, there is now around $17 trillion of debt trading at negative yields.[1] The amount of new municipal debt coming to market can't satisfy demand. Equities have enjoyed the longest bull market in our history. Surely, some must be anticipating the whistle telling them it's time to get out of the pool.

3. The debt binge is, of course, counter-intuitive. One pays down debt when times are good in order to better weather hard times. During a recession, you don't want half your shrunken revenues going to support debt service – right? Wrong! Just borrow more money if things get bad. Can't borrow? Then create it – with a key stroke as central banks are doing and then use the money to purchase securities, of course![2]

A municipal bond portfolio manager has choices. Currently most of them are bad, although tempting, as interest rates seem poised to drop even further. Short term high grades yield little, while long term high grades are incredibly vulnerable to rising rates when they come. Moral of the story; stay away from high grades. There are two alternatives. "Cushion callables" are bonds priced to a short call which will jump to much higher yields if not called. As the table to your right points out, you need to pay attention to the size of the coupon. Although in our example the 2% yield to the 5-year call is currently almost 100 basis points higher than new issue high grades maturing in 5 years, there is no guarantee that the call will be exercised. If your bond has a lower coupon, you will not be nearly as well rewarded as those owning a large coupon.

30-year bonds callable at par in 5 years

Coupon	Yield to Call	Yield to Maturity
2.00%	2.00%	2.00%
3.00%	2.00%	2.77%
4.00%	2.00%	3.49%
5.00%	2.00%	4.17%
6.00%	2.00%	4.80%

The other alternative, a defensive strategy[3], is to buy seasoned, non-rated issues in the secondary market where competition for modest sized blocks is minimal. This assumes you are on top of their credit profiles.

Obviously, we are about to be subjected to incredible political theater. In this regard, Noel Coward had the best advice for both sides: "Just say the lines and don't trip over the furniture."

[1] As recently as April of this year, that number was $10 trillion. [2] Please excuse the sarcasm. [3] If you want to go on the offensive, use equities or real estate. Something other than bonds.