

# MUNICIPAL MARKET OVERVIEW AND 2009 OUTLOOK *January 2, 2009*

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2008 was a very difficult year for municipal investors, but to ignore the opportunities the turmoil has created would be unfortunate. We feel that municipal credit concerns will be addressed over time and that the municipal market is an undervalued asset class, both of which will be discussed in greater detail within this report. Given the attractive values currently available in the market, 2009 could be a rewarding year for those who either initiate positions or add to existing holdings in the municipal market. Any potential tax policy changes that are made by the Obama Administration will likely only make the municipal bond market more attractive for investors.

If there was ever a time for professional management in the “sleepy” muni market, it’s now. We plan to capitalize on market opportunities identified within this report and to keep our eyes fully open to changing conditions throughout the year. We are hopeful that you find this report informative and helpful. We also hope that you keep these professionally managed funds and strategies in mind for your clients, especially those seeking a high level of current income that is exempt from federal income taxes.

[Marshall Intermediate Tax-Free Fund](#)  
[M&I Intermediate Tax-Free Strategy](#)  
[Marshall Tax-Free Money Market Fund](#)

## Overview

2008 was a very challenging year for investors in the municipal market. The widely followed Lehman (now Barclays) Municipal Indices were difficult to match on a performance basis. Only those portfolios with a significant allocation to the highest quality issues, and with a very targeted maturity structure, performed well relative to a typical benchmark. Portfolios that were more broadly diversified by maturity, credit quality, and market sector generally lagged their respective benchmarks.

For an asset class that has been perceived as too “sleepy” at times by some investors, 2008 was clearly a wake-up call. Like so many other asset classes, volatility soared to unprecedented levels and events occurred that few could have foreseen. To start, virtually all of the monoline insurers, upon which both individual and institutional investors had become overly-dependent, had their ratings downgraded, in many cases by several notches. These downgrades triggered a severe negative feedback loop which persisted throughout much of the year.

The disruption surfaced first in the short-term market, initially among the failed auction-rate securities and later the variable rate note market. Next, the turmoil extended out the yield curve as nontraditional investors, many of whom operate on a leveraged basis, were forced to sell as their profitability vanished due to a rising cost of funds. Their selling occurred in an already illiquid market, further hindered by a reduced number of municipal bond dealers, constrained by weakened balance sheets. As prices fell across much of the market, mutual fund redemptions began, leading to more selling and extending the vicious cycle further. Meanwhile, the weak economic backdrop caused state and local revenues to fall faster than budgets could be cut or taxes raised, resulting in burgeoning budget gaps. Alarming headlines followed which added to already heightened investor anxiety.



INVESTMENT MANAGEMENT

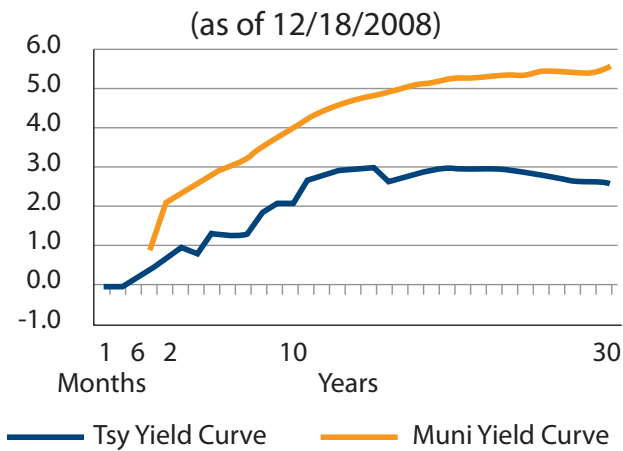
# Municipal Market Overview and 2009 Outlook

In this report, we seek to address directly some of the current credit concerns. It's impossible to deal with all municipalities in any single report since there are more than 50,000 issuers, but we attempt to put the broader municipal credit concerns in historical context. We analyze the major sources of tax revenue and major expenditures as well as the options municipalities have to close projected budget gaps.

We believe the economic and market turmoil of 2008 has

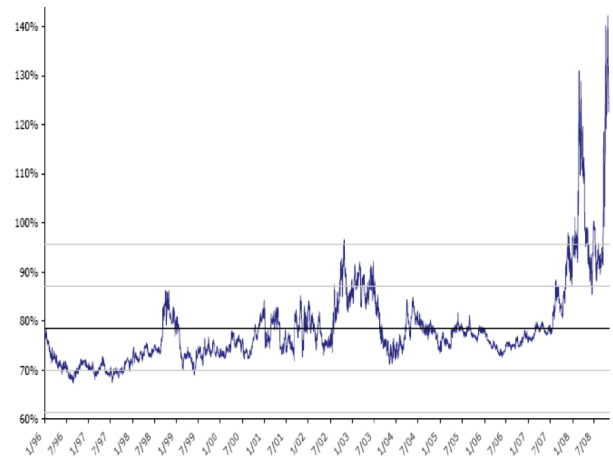
created incredible investment opportunities in 2009 for the astute and patient investor. Municipals are at historically cheap valuations relative to other fixed income sectors at year end as shown in the charts below. Even on a nominal basis, yields are quite attractive, particularly with the currently low inflation expectations. This report will outline where we see opportunities and how we hope to capitalize on them in our managed portfolios and funds.

## Muni vs. Treasury Yield Curves



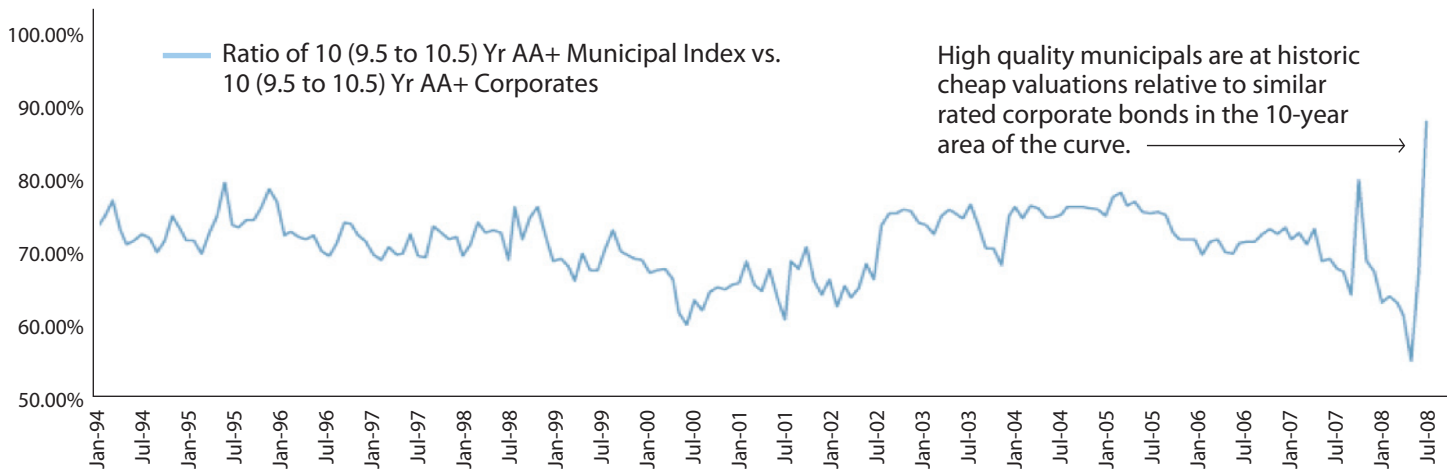
Source: Bloomberg, Merrill Lynch

## 5Yr Munis as % of 5Yr Treasuries (12/18/08)



Source: Yield Book, Thomson Financial/MMD and Citi

## AA+ Munis as % of AA+ Corporate Bonds (11/30/08)



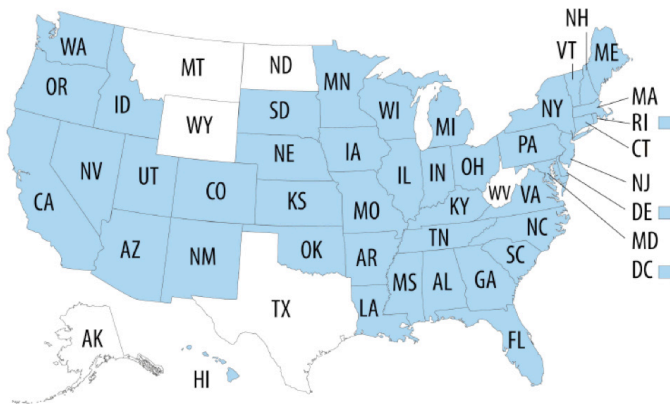
Source: Barclays Capital Municipal Strategies and Index Group

# Municipal Market Overview and 2009 Outlook

## Municipal Credit Concerns

Headlines now appear almost daily which highlight budget pressures among state and local governments. The intense media focus and the budget pressures will likely persist for the next several years. Part of the alarm in the near term is posturing on the part of municipalities seeking a portion of the much anticipated federal stimulus package, expected to be announced and discussed in late January. There is a precedent for federal assistance at the state and local level. Following the last recession of 2001, states were given federal aid to mitigate budgetary pressures and it's very likely that some portion of this stimulus will be directed to states and/or local municipalities.

Another reason for media attention is budget pressures have to **44 States Face Budget Shortfalls**



Note: Includes states with shortfalls in fiscal 2009 or projected shortfalls for fiscal 2010.  
Source: Center on Budget and Policy Priorities

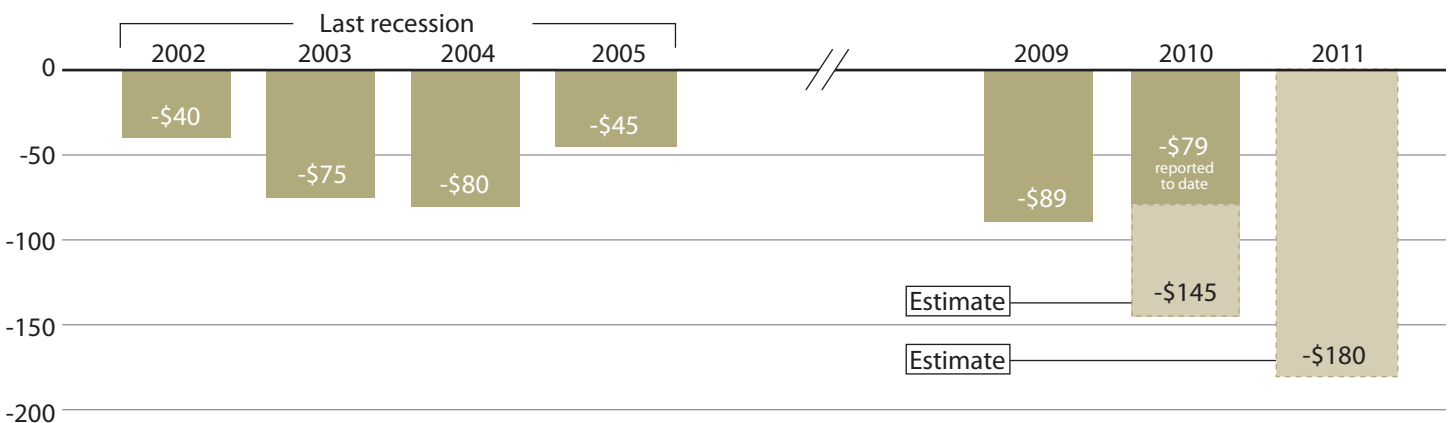
be addressed by each respective municipality. Unlike the federal government which runs sizable budget deficits year after year, every state but Vermont has a constitutional requirement to balance its budget. Most local municipalities operate under the same type of balanced budget requirement. Deferring deficits from year-to-year is simply not an option for most issuers.

What initially was a budget challenge for states with the weakest housing markets has now clearly become a nationwide issue. As many as 38 states have already estimated a mid-year budget gap for FY 2009 (the current fiscal year which began in July 2008) and 44 states now project deficits in FY 2010.

Given the amount of media attention, many investors are nervous about the municipal market. A recent report from the National Conference of State Legislatures (NCSL) indicated that states have already closed a collective \$40B budget gap in FY 2009, and as the economy weakens they project another \$32B budget gap before the current fiscal year is over. They also estimate a \$97B collective gap in FY 2010, which begins July 1, 2009. Others, as shown in the chart below, have even higher estimates.

Relative to the growth in the size of state budgets, however, the FY 2009 deficits are in-line with those of 2003, which was the fiscal year following the start of the 2001 recession. In total, states closed budget gaps of approximately \$240B during and following the 2001 recession (gaps recorded in fiscal 2001–2005). While we are not at that level yet, some are projecting significantly higher deficits over the next several years.

## Total State Budget Deficits in Each Fiscal Year (Billions)



Source: Center on Budget and Policy Priorities

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Although we are still in the midst of the recession, the unemployment rate is already higher than its peak in June 2003. Many expect it to exceed 8% before it begins to improve. As unemployment climbs, state income tax revenues fall and demand for Medicaid and other human services rise. In addition, sales tax revenues fall as consumer spending slows. Since income taxes and sales taxes are the two largest sources of revenues for most states, as indicated in the table below, the severity of the current recession will likely result in budget deficits well exceeding those of the last recession.

## Sources of State Government Tax Collections (2007)

Tax Source:	All States	AZ	FL	MN	WI
Property	1.6%	3.5%	0.1%	3.8%	0.8%
Sales	46.1%	59.2%	77.0%	41.1%	41.7%
Licenses	6.2%	3.2%	5.2%	5.5%	5.9%
Income	42.6%	33.7%	6.8%	47.3%	50.1%
Other	3.5%	0.4%	10.9%	2.3%	1.5%
	100%	100%	100%	100%	100%

Source: U.S. Census Bureau

The Center on Budget and Policy Priorities estimates that nineteen states will have double-digit percentage gaps in FY 2010, with gaps in FL, LA, NY, WI, AZ and CA all projected to exceed 20% of total revenues (see Appendix).

To close these projected gaps the NCSL reports that:

- At least ten states have already imposed across-the-board budget cuts and another ten are considering the same.
- Nineteen states have implemented hiring freezes; fourteen have banned travel, while another four have frozen salaries.
- Five states have tapped their rainy day (reserve) funds and six others are looking at doing so.

## Keeping State Credit Concerns in Perspective

It is important to note that debt service is generally a relatively low percentage of total expenditures at the state level. For most states, debt service comprises just 5%–6% of the total budget, either due to self-imposed limits or statutory debt restrictions. For example, Florida has a target debt service limit of 6% of state revenues, with a constitutional limit of 7%. New York limits outstanding debt to 4% of total annual personal income and debt service to 5% of all receipts. Arizona, which is among the states with the highest projected FY 2010 budget gap as a percentage of total revenues (see Appendix), allocates just 1.8% of its total budget currently for state-supported debt. Each state is different, of course, both in terms of the amount and structure of debt outstanding, but as a percentage of total revenues debt service is typically very manageable.

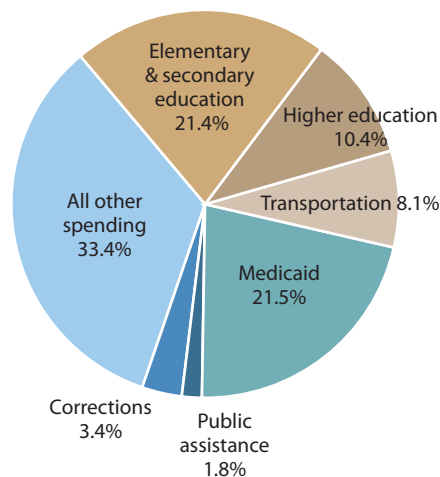
As shown in this pie chart, Medicaid and primary education make up the biggest slices of state budget expenditures, when combining both state and federal funds. Each accounted for about 21% of spending in 2007. Some states have already made cutbacks to health services provided, or are considering restricting services. According to Barclays, states are asking for a temporary increase in the federal share of the joint-federal Medicaid program, which annually costs state and the federal government \$330B.

President-elect Barack Obama recently met with governors in Philadelphia to discuss state fiscal conditions. Although no specific dollar amount of aid was discussed at the December 3rd meeting, in a follow-up letter the National Governors

Association called for \$136B to pay for infrastructure projects that are ready to be implemented within 90 days and at least an additional \$40B toward the Medicaid program for the poor and disabled.

In addition to the likely federal assistance, states have a number of means to deal with the budget pressures. It is likely that further and more severe budget cuts will have to be made in many states. Not filling vacant positions or requiring a few days

## State Expenditures — 2007



Source: National Association of State Budget Officers

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of unpaid holidays won't be sufficient if the economy remains weak well into 2009. Across the board, cuts will likely be made, and budget pressures will undoubtedly be pushed down to the local municipal level. It's also very likely that taxes and fees will rise in many states. Already, New York's Governor Paterson is proposing tax and fee increases that would generate \$4B of additional revenue. California, along with other states, is considering similar moves.

One-time budget gimmicks, which have been common among municipal governments historically, are insufficient when revenues fall as sharply as in the current environment. The political will to make real, meaningful cuts, or to seriously address the revenue side of the income statement, can no longer be postponed. At some point, politics must be set aside and tough decisions made. That time is rapidly approaching for many states, if not already here. It may not be easy, or pretty, but ultimately we fully expect that states will take the corrective measures necessary to balance their budgets.

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## Local Municipalities Credit Perspective

We do expect to see more real credit pressures at the local municipal level (i.e., counties, cities and school districts), where there is less flexibility in terms of raising taxes and fees than at the state level. Debt service often takes a larger portion of total revenues than at the state level (up to 10%–15% in some cases), while states can and do reduce aid payments to local municipalities during tough economic times. We are already seeing this occur or discussed in many states. For example, in Minnesota, part of Governor Tim Pawlenty's plan to close the budget gap is to reduce state aid to municipalities by \$110M. Cities would lose \$66M, and counties would lose \$44M (another \$40M would also be cut from universities as well as \$73M in human services).

As tough as these cuts are, local municipalities have an advantage that states don't. As shown in the table on page 4, states are primarily dependent upon income and sales taxes for the vast majority of their revenues, both of which are procyclical; as the economy slows, so does the revenue from each source. For local municipalities, property taxes typically comprise a large portion of their revenue stream. Property tax assessments and revenues clearly can go down in a slowing economy (especially those communities hardest hit by the housing decline), but cycles are much longer and more gradual than the more volatile income or sales tax revenues. This often provides local municipalities more time to plan for and make necessary budget adjustments. In addition, property taxes

ultimately get paid, if not by the individual homeowner, then by the bank that takes a property into foreclosure or the next buyer in a tax lien sale. Despite some horrific housing markets in various regions of the country, and concerns that we've not yet seen the bottom in housing, property tax revenues will continue to flow into municipal coffers.

This is not to say that local demographic trends and the employment base are not important in analyzing municipal credits. If a community is experiencing no growth with an aging population, or net migration out, then long-term trends will surely continue to deteriorate. Yet, even these are typically long-cycle trends, occurring over many years, if not decades. The credit decline in these communities and regions is also generally well known. Large urban communities with heavy infrastructure needs and an already heavily taxed citizenry will likely continue to see their credit and ratings profile decline unless some significant outside influence causes a change in course.

Communities that benefit from favorable demographic trends should, if properly managed, experience stable to rising credit and rating profiles once the current economic malaise passes. The Southeast and Southwest regions are good examples. Although hard hit by the housing crisis, an expanding tax base will help meet their growing borrowing needs in the future.

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## Revenue-Backed Credits

The credit discussion so far has been focused on general obligation credits. Yet, many municipal credits are dependent upon a dedicated revenue stream as opposed to the full taxing power of a community or state. Historically, revenue obligations have been perceived as having a weaker security structure than general obligations. Yet, many revenue issues, particularly those that fall into the "essential service" category, have a very strong credit profile and often enjoy less political pressure than do general obligation credits.

What qualifies as essential service revenues is subject to debate, but typically water and sewer revenue bonds as well as electric utilities would fall into this category. The issuing authorities generally have the latitude to set rates sufficient to pay debt service, often with only minimal, if any, oversight from a regulatory body. Rate levels are set with a relatively modest cushion to the debt service requirement, and carry a comfortable level of reserves to smooth any revenue declines

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over short periods. Other, less-essential, revenue issues which are common in the municipal market are: transportation revenues (backed by gasoline taxes and/or vehicle registration fees), toll roads, airports, universities, hospitals and dedicated sales tax revenues.

Many of the dedicated revenues, essential or not, are also tied to the economic cycle. The less essential the revenue source, the more volatile the revenues, typically. The more volatile the revenue source, the more debt service coverage that is generally required during the underwriting and rating process. For example, a AA rated water and sewer revenue issue might be expected to cover debt service 1.5 – 2.0x, ample cushion for a very stable revenue source. Yet, a AA rated bond backed by

sales tax revenues, which can fluctuate dramatically with economic activity, may cover debt service 10x, or more, in a stable economic environment.

Each revenue issue must be analyzed on its own merits. Despite some lingering market perceptions to the contrary, having a dedicated revenue stream that is easy to track and, importantly, less influenced by political posturing can be a very strong credit in any portfolio. In addition, yields tend to be higher on revenue issues than on general obligations, so they also serve to enhance portfolio income. For investors who can do the credit analysis, we believe revenue-backed issues should be considered as part of the core holdings in a diversified portfolio.

## Fading Insurance Support

For investors who have historically taken comfort in the second layer of credit support provided by the monoline insurers, tremendous uncertainty is likely to persist here as well. Because of the challenges on the structured product side of the monoline insurers' business, the rating agencies have been very severe in their rating adjustments. Moody's has challenged the viability of the insurance business model. Investor confusion over this is understandable. For many years the rating agencies awarded their coveted AAA rating to the insurers, claiming they could withstand "depression-era default scenarios." Yet, when problems in the mortgage-backed securities market surfaced, it was clear that the insurers had significant exposure. Their business model and credit ratings eventually came into question.

When 2008 began, all of the major monoline insurers were rated AAA by each of the rating agencies. Now, only one, a new entrant that didn't exist a year ago (BHAC - Berkshire Hathaway Assurance Corp.), carries the highest rating from both Moody's and S&P.

Only BHAC, Assured Guaranty and FSA currently add any trading value to bonds that carry their guarantee, and even this perceived value can be quite fleeting. Retail investors are clearly more dependent on the insurance than are institutional investors which create "arbitrage" opportunities between the two market segments. Municipal investors must recognize that reliance on insurers to provide top tier quality ratings is essentially over. Without meaningful additional capital, it's likely they will play a much reduced market role in 2009, providing a more meaningful role for professional credit analysis going forward.

### Insured Municipal Ratings (12/31/08)

Insurer	Moody's	S&P	Fitch
1) ACA	Not Rated	Not Rated	Not Rated
2) Ambac	Baa1 (Dev Outlook)	A (Neg Outlook)	WD
3) Assured Gty	Aa2 (Sta Outlook)	AAA (Sta Outlook)	AAA (Sta Outlook)
4) BHAC	Aaa (Sta Outlook)	AAA (Sta Outlook)	Not Rated
5) CIFG	B3 (Dev Watch)	B (Dev Watch)	WD
6) FGIC	Caa1 (Neg Outlook)	CCC (Neg Outlook)	WD
7) FSA	Aa3 (Dev Outlook)	AAA (Neg Watch)	AAA (Neg Watch)
8) MBIA	Baa1 (Dev Outlook)	AA (Neg Outlook)	WD
9) Radian	A3 (Neg Watch)	BBB+ (Neg Watch)	WD
10) XLCA (Syncora)	Caa1 (Dev Watch)	B (Dev Watch)	WD

Source: Bloomberg

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## Keeping All Muni Credits in Perspective

Although rating agencies have come under justifiable criticism in recent months (primarily for their faulty inflated ratings on many structured products in the taxable market), their ratings analysis in the municipal market has withstood the test of time. Arguably, the historic default rate of the municipal market suggests that the agencies have been rating muni credits appropriately for decades. It is, perhaps, the taxable ratings that are inflated.

The rating agencies admit to a different rating standard for municipal versus corporate credits. As shown in the chart below, municipal issues have a much lower historic default rate than similarly rated corporates. Municipal credits are rated on a more conservative rating scale that highlights the relative risk between munis, rather than the absolute default risk as it does for corporate issues. In other words, a BBB and a AA municipal school district will have very similar and very low, projected default probabilities, yet the default probability of a BBB corporate is roughly nine times greater than a AA corporate bond.

### Average 10Yr Cumulative Issuer Weighted Default Rates (1970-2006)

Initial Rating	Municipals	Corporate
AAA	0.00%	0.52%
AA	0.06%	0.52%
A	0.03%	1.29%
BBB	0.13%	4.64%
Inv Grade	0.07%	2.09%

Source: Moody's

Similar to the corporate market, where ratings downgrades and defaults typically peak after the economy has bottomed, municipal downgrades also tend to trail state revenue shortfalls. The lag between falling revenues and ratings changes is partly due to the very slow municipal disclosure cycle, but is primarily because of the lagging tax assessment/collection cycle referred to earlier. Often, credit conditions appear most dire when the economy is well on its way to recovery and tax revenues have already begun to improve. Because of this, perceived municipal credit challenges may persist in this cycle well after the corporate sector and credit spreads have begun to recover.

It's important to separate headline risk and ratings risk from the actual risk of default on debt service payment among municipal credits. Unlike the corporate market, where it's very likely that payment defaults and bankruptcies rise in 2009 (we believe this is more than factored into corporate credit spreads already, however), the risk of payment default, let alone a bankruptcy filing, in the municipal market will likely remain a very rare event. In many states, bankruptcy is not a legal option to consider. Where it is allowed, municipalities understand that the consequences of a bankruptcy filing (whether threatened or real) are serious. Their access to the capital markets could be difficult, if not impossible, for years, inhibiting their ability to raise money for important needs. Therefore, bankruptcy is a decision that municipalities do not take lightly.

In summary, although we believe the historically low default rate of municipals may be tested in this cycle, depending on the depth and length of the recession, we believe the favorable credit characteristics we've outlined will allow municipalities to weather this storm. Municipalities are already well-along in the process of addressing their budget challenges directly, and we expect they will continue to do so until economic conditions and budgetary pressures improve.

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## Opportunities in the Municipal Market

In our opinion, the opportunities in the municipal market are plentiful. The value of the municipal sector is outlined in the charts on page 2. Both on a nominal and relative basis, yields are appealing in our view. Below we discuss our views on various decisions that go into building and managing a municipal portfolio, and our suggested approach currently.

### Maturity

Municipal yields have risen to a level that even on a nominal basis are appealing to many investors. With inflation expectations for the next few years near zero, if not negative (or deflationary), the real return on municipal yields at current levels are above the long-term average. When municipal yields are viewed relative to Treasury yields the comparison easily favors municipals.

#### Yields as of 12/31/08

Maturity	Treasury	AAA Muni	Spread (bps)	Muni/Treas Yield Ratio
2Yr	0.76%	1.88%	1.12	247.4%
5Yr	1.55%	2.47%	0.92	159.4%
10Yr	2.21%	3.52%	1.31	159.3%
30Yr	2.68%	5.04%	2.36	188.1%

Source: Thomson Financial/MMD, Bloomberg

When tax rates are factored in, at various yield levels and at varying current and potential tax rates, the pre-tax yield levels are also quite attractive to federal agency and even higher quality corporate yields. Given the historically lower default rate of the municipal market relative to corporates, we also believe the risk/reward tradeoff continues to favor municipals.

#### Pre-Tax Yields at Varying Tax Rates

##### Tax-Exempt

Yield	28%	35%	40%
3.0%	4.2%	4.6%	5.0%
4.0%	5.6%	6.2%	6.7%
5.0%	6.9%	7.7%	8.3%
6.0%	8.3%	9.2%	10.0%

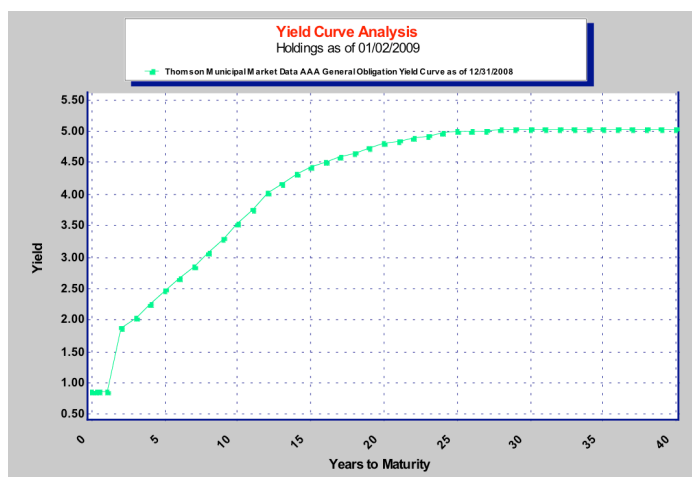
For these reasons, we believe that managed municipal portfolios should be at least neutral, if not long, to their respective benchmark as we enter 2009.

## Yield Curve

The municipal yield curve is as steep as we've seen since the early 1980s. Given the near-term outlook for a weak economy, we suspect that the shortest maturities will be anchored by a fed funds rate at or near zero for an extended period. Yet, there are pent-up supply pressures; issues that could not come to market in 2008 will likely attempt to clear the market in 2009. The relatively abundant supply should keep the curve in a steep structure for most if not all of the year. With that, the "roll-down" opportunities should be significant. As bonds age along a steep yield curve, they gradually appreciate in value, enhancing portfolio return.

We want to emphasize the intermediate portion of the yield curve to capture this positive roll effect. Currently, maturities between four and twelve years offer the best risk/reward tradeoff, in our view.

#### Yield Curve Analysis



Source: MMD Interactive, InvestorTools

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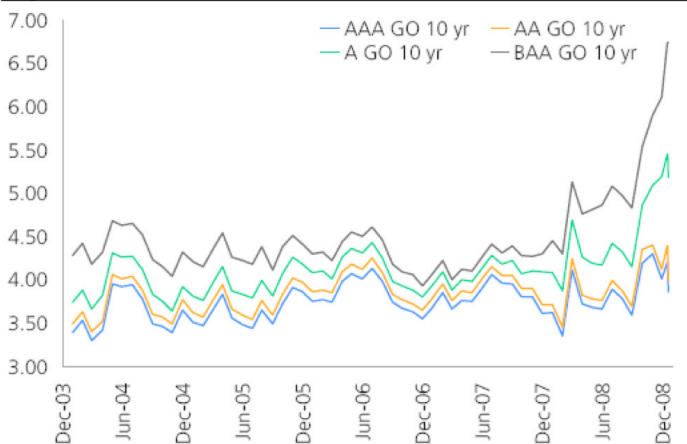
## Credit

As outlined earlier in this report, credit concerns will likely persist in the municipal market for the next few years. Caution is clearly warranted, at least until there is greater clarity as to the economic backdrop and how municipalities address their budget pressures. Investors already recognize these credit concerns and this remains a primary reason for the value we now see in the municipal sector. With the lack of clarity among credits, and the perceived safety of the monoline insurance now effectively gone, many individual investors fear trading beyond the highest rated issues. This is evident in the chart below showing municipal yields by rating category. Although, in our view, all municipals are undervalued, regardless of their credit quality, spreads on A or BBB rated issues have clearly widened.

In portfolios, we currently believe core holdings in the AAA and AA ratings categories should represent 70%-80% of the total. The remainder of the portfolio, however, should be broadly diversified among A and some BBB rated securities on a selective basis to capture the attractive yields in that segment of the credit market. Professional analysis and credit management are especially important in this segment of the ratings spectrum.

### Yields on Munis Below 'AA' Have Been Rising More Than Higher-Rated Bonds

Yields on munis below 'AA' have been rising more than higher-rated bonds



Source: MMD Interactive, UBS (Yields as of 12/18/08)

## Sectors

It is easy to suggest an above-average allocation to general obligation credits in the current environment. The full faith backing provides both comfort and liquidity to portfolios. Also, pre-refunded issues, which are guaranteed by government-backed securities held in escrow, are the highest quality and remain undervalued. Yet, just as with wider quality spreads on the A and BBB rated issues above, yields on non-general obligation sectors have also widened. On a selective basis we believe essential service revenue issues should also be broadly included in portfolio holdings.

Among the very cheapest sectors of the municipal market currently are health care and housing-related bonds. Smaller health care systems tend to fall into the low-investment grade rating categories and need to be analyzed very carefully. Yet, health care is an essential service for a rapidly aging segment of our population, namely the baby boomers. Many of the larger health care systems are among some of the stronger credits in the market and should not be overlooked.

Housing issues, specifically those backed with federal agency backing (e.g., Ginnie Mae or Fannie Mae), carry the AAA rating of these agencies just as the agency-backed mortgages do in the taxable market. Yet, they regularly trade cheaper in the tax-exempt market than in the taxable market. Liquidity concerns are one reason, but also many of the pre-2008 housing bonds are also subject to the alternative minimum tax (AMT), making them less appealing to many. For those portfolios where AMT issues do not create a tax problem, these issues should certainly be considered.

## Security Selection

We believe that it would be advantageous to focus on non-call issues to "lock-in" the attractive valuations in the municipal sector. If the weak economic scenario plays out gradually over the course of 2009, even into 2010, the convexity that non-call issues provide should prove rewarding as municipal valuations revert to the mean.

Given the wide disparity between tax-exempt yields and Treasury yields, the possibility of advance refunding outstanding issues is unlikely. Therefore, the anticipated boost that occurs when a callable issue is refunded will be rare for the foreseeable future. Yet, exposing a portion of the portfolio to call risk, where some of the issues may be called away prior to maturity, even within the next few years, may be a way to enhance portfolio yield. The optionality embedded in these callable issues is often not properly valued in the municipal market, and municipalities are also not entirely efficient at calling securities even when they should. The longer that yields remain high, the less likely calls are to be exercised. Owning some issues with shorter call exposure may also be advantageous in the current environment.

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Finally, due to the sharp rise in yields, many securities are trading at market discounts. That is, bonds that have traded to a deep discounted price due to market conditions (i.e., rising market yields), not because they were issued as such. These securities carry unique tax consequences when purchased in the secondary market, creating taxable income when sold or even if held to maturity. Yet, the market overly-penalizes these issues and for those portfolios that are perhaps less tax-sensitive, they may be a way to enhance performance as market prices improve.

## Conclusion

2008 was a very difficult year for municipal investors, but to ignore the opportunities the turmoil has created would be unfortunate. In spite (or because) of municipal credit concerns, attractive values are currently available in the market, and it is our position that 2009 could be a rewarding year for those who either initiate positions or add to existing holdings. If there were ever a time for professional management in the “sleepy” muni market, it’s now. We hope to capitalize on market opportunities identified above and will keep our eyes fully open to changing conditions throughout the year.

*For more information regarding these Marshall Funds and separately managed account strategies, please contact:*

**Thomas Nolte**, Director of Institutional Sales, 414-287-8787

**Scott Jennings**, Product Manager – Fixed Income, 414-426-7576

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# Municipal Market Overview and 2009 Outlook

## Appendix

### States with Projected FY 2010 Budget Gaps

	Size of Gap	Percent of FY2009 General Fund
Alabama	DK	
Arizona	\$2.2 billion	21.9%
Arkansas	\$146 million	3.2%
California	\$25.0 billion	24.8%
Colorado	\$386 million	4.9%
Connecticut	\$2.5 billion	14.5%
Delaware	\$304 million	8.3%
Florida	\$5.8 billion	22.6%
Hawaii	\$682 million	11.9%
Idaho	DK	
Iowa	\$718 million	11.3%
Kansas	\$1.0 billion	16.0%
Kentucky	DK	
Louisiana	\$2.0 billion	21.7%
Maine	\$177 million	5.8%
Maryland	\$1.8 billion	12.5%
Massachusetts	DK	
Michigan	\$1.6 billion	6.9%
Minnesota	\$2.5 billion	14.7%
Mississippi	\$87 million	1.7%
Missouri	DK	
Nebraska	\$152 million	4.3%
Nevada	DK	
New Jersey	\$4.0 billion	12.3%
New Mexico	DK	
New York	\$13.7 billion	24.3%
North Carolina	\$2.7 billion	12.5%
Ohio	\$2.0 billion	7.1%
Oklahoma	\$310 million	4.7%
Oregon	DK	
Rhode Island	\$450 million	13.7%
South Dakota	\$32 million	2.7%
Tennessee	\$712 million	6.3%
Utah	\$721 million	12.1%
Vermont	\$166 million	13.6%
Virginia	\$1.8 billion	10.4%
Washington	\$2.8 billion	18.2%
Wisconsin	\$2.9 billion	20.3%
<b>TOTAL</b>	<b>\$79.4 billion</b>	<b>16.6%</b>

Note: An entry of "DK" in Size of Gap means that an estimate of the size of the projected gap in that state is not yet available.