

Municipal Market Comments



December 5, 2011

from  Montage Investments

Fitch Revises USA Outlook to Negative

On Nov. 28, 2011, Fitch Ratings affirmed its AAA rating on the United States of America but revised its long-term outlook for the U.S.A. to Negative from Stable. As it now stands, the U.S. is rated Aaa/AA+/AAA by Moody's, S&P and Fitch, respectively, and has a negative rating outlook from all three agencies.

In affirming its rating, Fitch outlined its expectations of a timeframe for deficit action extending into 2013, after next year's Presidential and Congressional elections. Fitch's rating release stated that its negative outlook indicates a greater than 50% chance of a downgrade within a two-year timeframe and reflects "declining confidence that timely fiscal measures necessary to place U.S. public finances on a sustainable path and secure the U.S. 'AAA' sovereign rating will be forthcoming." Fitch elaborated on its expectations for the rating going forward by noting that "failure to reach an agreement in 2013 on a credible deficit reduction plan and a worsening of the economic and fiscal outlook would likely result in a downgrade of the U.S. sovereign rating."

Given the comments from the rating agencies in recent days, it appears to us that the U.S. sovereign credit rating will remain at current levels at least into the first quarter of 2013, absent any major event that significantly changes the fundamental economic and fiscal picture in the interim.

Assured Guaranty Downgraded to AA

On Nov. 30, 2011, S&P downgraded Assured Guaranty Ltd. (NYSE: AGO, rated A3/A-) to A- from A+. The action, the result of S&P revising its rating criteria for bond insurance companies, also triggered a downgrade of AGO's operating companies' ratings. As a result, the rating of Assured Guaranty Municipal (AGM, Aa3/AA-), the only currently active municipal bond insurer, was dropped to AA- from AA+. S&P's outlook for AGM is now stable.

AGM was formed from the combination of Assured Guaranty Corp. and FSA in July 2009, with AGM becoming the municipal bond insurer. As a result of that merger, all of the bonds that have historically been issued with insurance policies from either Assured or FSA are now guaranteed by Assured. Following this downgrade, these bonds are now rated Aa3/AA-. Year-to-date in 2011, AGM has insured approximately 5% of municipal new issues.

As we wrote in our Sept. 9, 2011 comments on AGM, Ascent's approach to bond insurance is to "look through" the insurance to evaluate the underlying credit characteristics of the bond issuer and to only invest in bonds that we believe offer very high credit quality on their own merits. Consequently, we do not view this downgrade as a reason for current holders of AGM-insured bonds to sell those positions, as we expect issuers with strong underlying credit quality will maintain market acceptance and not suffer significant price impacts.

S&P Criteria Change Triggers Bank Downgrades

On Nov. 30, 2011, S&P released its review of 37 of the largest international banks, the culmination of a change in its rating criteria for banks. S&P's criteria changes resulted in downgrades of most of the largest U.S. banks. Moody's and S&P typically rate bank holding companies one notch lower than the operating subsidiary banks of that company, and in each case, both the holding company rating and the bank rating was lowered one notch by S&P. Among the banks affected were:

Company	S&P Rating Action	Current Ratings*	Current Outlooks*
Bank of America Corp.	To A- from A	Baa1/A-/A+	Negative/Negative/ RatingWatch Negative
Bank of America N.A.	To A from A+	A2/A/A+	Negative/Negative/ RatingWatch Negative
Bank of N.Y. Mellon Corp.	To A+ from AA-	Aa2/A+/AA-	Negative/Negative/Stable
The Bank of N.Y. Mellon	To AA- from AA	Aaa/AA-/AA-	Negative/Negative/Stable
Citigroup Inc.	To A- from A	A3/A-/A+	Negative/Negative/ RatingWatch Negative
Citibank N.A.	To A from A+	A1/A/A+	Negative/Negative/ RatingWatch Negative
Goldman Sachs Group Inc.	To A- from A	A1/A-/A+	Negative/Negative/ RatingWatch Negative
JPMorgan Chase & Co.	To A from A+	Aa3/A/AA-	Negative/Stable/Stable
JPMorgan Chase Bank N.A.	To A+ from AA-	Aa1/A+/AA-	Negative/Stable/Stable
Morgan Stanley Inc.	To A- from A	A2/A-/A	Negative/Negative/ RatingWatch Negative
Wells Fargo & Co.	To A+ from AA-	A2/A+/AA-	Negative/Stable/Stable
Wells Fargo Bank N.A.	To AA- from AA	Aa3/AA-/AA-	Negative/Stable/Stable

*ratings and outlooks for Moody's, S&P and Fitch, respectively
Sources: Moody's; S&P; Fitch

S&P's downgrades follow Moody's September downgrades of many of the same banks, which were also driven by a revision in the way in which that agency analyzes banks. The new criteria heavily weigh the general economic condition and credit rating of the sovereign nation in which the banks primarily operate. That sovereign rating sets the baseline for bank sector ratings in that country. S&P's anchor rating for the US banking sector is now BBB+. That rating is then adjusted based on multiple credit factors including capital structure, business position and funding/liquidity. Also factored in is an adjustment for the degree of support the sovereign government would be expected to provide in the event of a financial disruption. For example, U.S. bank holding companies and their operating banks would each be rated one to three notches lower than their current ratings in the absence of U.S. government support.

For the domestic banks, the major credit considerations facing them in the near term include:

- **The U.S. sovereign credit rating.** If the USA is downgraded, the anchor rating for the bank sector drops, too, resulting in a downgrade of the banks by the same number of notches.
- **Loan portfolio performance.** Residential and commercial mortgage portfolios are still performing poorly, though generally better than at their worst levels.
- **Quality of earnings.** There is some concern that earnings have been driven by reserve releases and other accounting factors that mask the weakness of the core enterprise.
- **Exposure to Europe.** Exposure to distressed Euro-zone countries varies among the banks. Larger Eurozone disruption, or instability of international financial systems, is an unavoidable risk that cannot be easily quantified.

Until there is a more robust, sustained economic expansion in the U.S. that includes some improvement in housing and real estate markets, bank credit quality will largely be driven by macro developments affecting the U.S. credit rating and events in Europe. We expect that the extent to which banks' credit quality changes in the near term will largely be a function of the degree of support that the federal government and/or the Fed is willing to provide, especially with respect to availability of cheap liquidity.

In the near-term, we do not envision a scenario in which the U.S. would not support its major banks with extraordinary efforts to ensure access to liquidity and short-term funding. As a result, we are comfortable that the major banks will be in a position to fully support short-maturity senior debt obligations. However, given the intermediate to long-term potential for significant banking regulation and other capital structure effects from a Euro-zone driven banking crisis, we would not hold any subordinated securities of large, internationally-exposed US banks and would limit our secured debt holdings to maturities within 3-5 years.

A handwritten signature in black ink, appearing to read "Brian Tournier".

Brian Tournier
Director of Research
Ascent Investment Partners

Disclosure: This newsletter is limited to the dissemination of general information pertaining to Ascent Investment Partners, LLC's ("Ascent Investment Partners") investment advisory services and general economic market conditions. The information contained herein should not be construed as personalized investment advice, and should not be considered as a solicitation to buy or sell any security or engage in a particular investment strategy. There is no guarantee that the views and opinions expressed in this newsletter will come to pass.

Ascent Investment Partners is an SEC registered investment adviser with its principal place of business in the State of Missouri. Ascent Investment Partners and its representatives are in compliance with the current registration and notice filing requirements imposed upon registered investment advisers by those states in which such registration or notice filing is required. Ascent Investment Partners may only transact business in those states in which it is noticed filed, or qualifies for an exemption or exclusion from notice filing requirements. Any subsequent, direct communication by Ascent Investment Partners with a prospective client shall be conducted by a representative that is either registered or qualifies for an exemption or exclusion from registration in the state where the prospective client resides. For information pertaining to the registration status of Ascent Investment Partners, please contact Ascent Investment Partners or refer to the Investment Adviser Public Disclosure web site (www.adviserinfo.sec.gov). For additional information about Ascent Investment Partners, including fees and services, send for our Disclosure Brochure using the contact information herein.