Janney FISR
December, 2013

Philadelphia Council for Business Economics
A Chapter of the National Association for Business Economics (NABE)

Fixed Income & Macro Outlook 2014: Rate Risk Remains

Janney
CAPITAL MARKETS

See page 37 for important information regarding our certifications as well as other disclaimers.

Janney Macro & Fixed Income Outlook 2014 – Market Strategy

- *What is normal, anyway?* **Five years after the Global Financial Crisis, economic growth continues to unfold sluggishly and interest rates remain stubbornly low**

- **Once again, *the* key driver of markets in 2014 is likely to be Fed policy, and with the transition to Yellen, expect less QE, more guidance, and an effort to keep short term rates lower for longer**

- **For "go anywhere" investors, fixed income markets have shifted from a source of portfolio return to a source of protection against declines in equity markets**

- **We recommend staying well shorter in duration than the overall markets, and concentrating new purchases in the 5yr and under durations**

- **For investors with an exclusive need for current period income, the tradeoff for shorter duration is much less obvious**

Segment		2014 Position	Comments
GDP Growth	–	Neutral	Speed limits mean growth remains stable
Inflation	–	Neutral	Fed may try to spur, but won't hit til '15
Treasuries	↓	Underweight	5YR should show stable returns
Agencies	–	Neutral	5YR/1YR callables have great carry
Agency MBS	↓	Underweight	Sensitive to Fed taper decision
IG Credit	–	Neutral	Spreads tight, likely slightly better than Tsys
HY Credit	↑	Overweight	Only "absolute return" asset left in fixed income
Municipals	↑	Overweight	Tax benefit provides return "subsidy"

Source: Janney FISR

Janney Fixed Income Outlook 2014 – Sector Takeaways

- **Interest Rates:** We expect longer term interest rates to rise in 2014 as the Fed begins slowing bond buys; short term rates should remain anchored

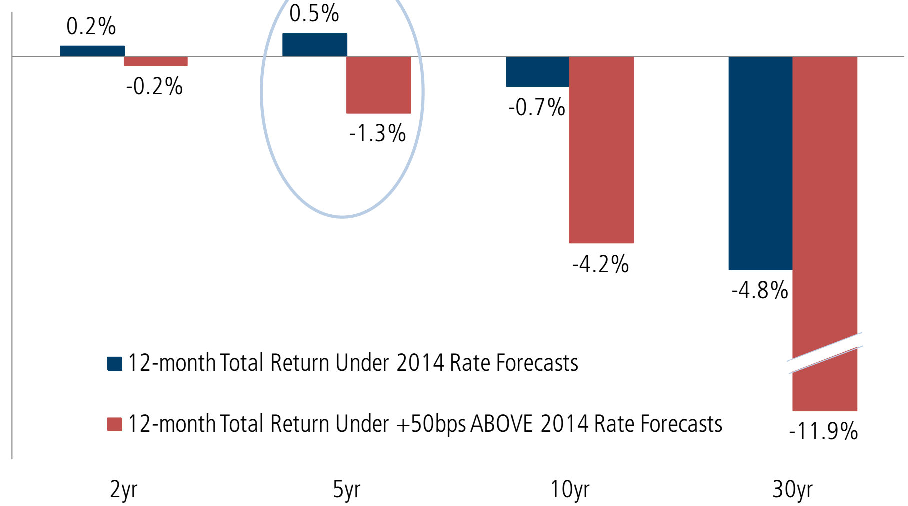
  Overall, we recommend keeping durations significantly shorter than normal, as rate risk is the primary risk within the fixed income markets—and it's easily avoidable, though there is an income give-up.

  The 5yr area of the yield curve is the most attractive, and best accessed via callable agencies, HY credit, and munis.

- **Corporate Credit:** In investment grade, credit spreads are near recent tights, implying limited cushion against interest rate risk, particularly for higher-rated credits; high yield spreads will likely benefit from the continual hunt for yield, but the potential for a correction in the equity markets poses a risk

- **Municipals:** While higher rates on the long end will negatively impact the muni markets, the relatively higher income generated by the tax-exemption along with higher tax rates means that munis are looking like the strongest income play

Total Returns Based On Janney Rate Forecasts Recommend 5yr Part of Yield Curve



Taxable Equivalent Yields Allow Apples to Apples Yield Comparison

Federal Bracket	28.0%	33.0%	35.0%	39.6%
Total with Medicare	28.0%	36.8%	38.8%	43.4%
Tax Free Yields	Taxable Equivalent Yields			
2.00%	2.78%	3.16%	3.27%	3.53%
3.00%	4.17%	4.75%	4.90%	5.30%
4.00%	5.56%	6.33%	6.54%	7.07%
5.00%	6.94%	7.91%	8.17%	8.83%
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Assumes Medicare Tax is applied to investment income in federal brackets of 33% and above. Certain investors in the 33% bracket may not be subject to all or any of the Medicare tax.

Source: Janney FISR

Economics

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2014 Economic Outlook

1. We're calling for steady economic growth in 2014 vs 2013, with GDP expansion of 2.1% – 2.5%, which is about as rapid a growth as we can expect based on the secular economic backdrop

2. Jobs growth has accelerated and should sustain at a 180 – 200K monthly pace, which would push the unemployment rate to 6.5% – 6.8% by year end, though the usefulness of the "raw" unemployment rate is limited by changes in the composition of the job markets and falling participation

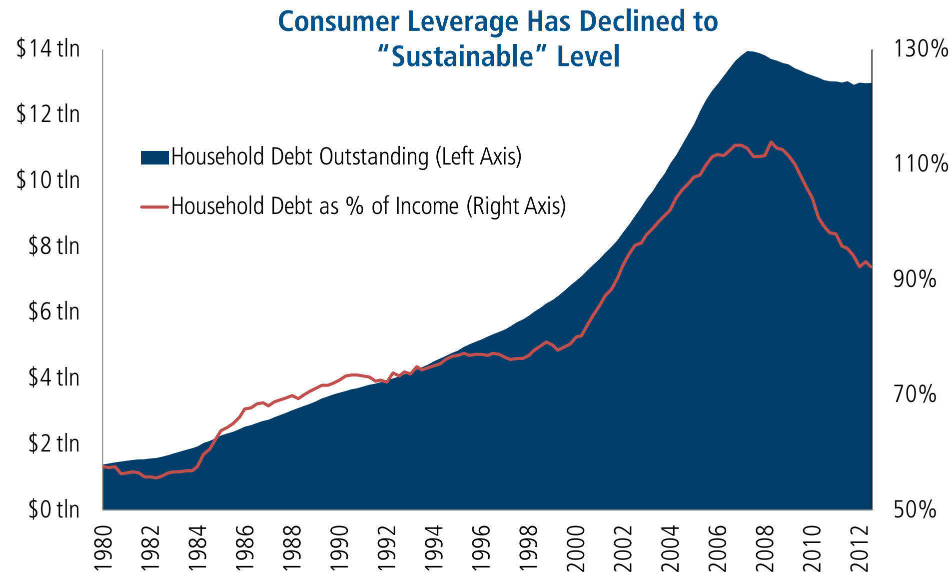
3. Disinflation continues to loom, despite five years of expansionary monetary policy; we believe the Fed will set itself up to tolerate significantly higher rates of inflation, but that inflation will remain constrained in 2014, falling in the 1.5% – 1.7% (core CPI) / 1.1% – 1.3% (core PCE) range, only accelerating in 2H 2015

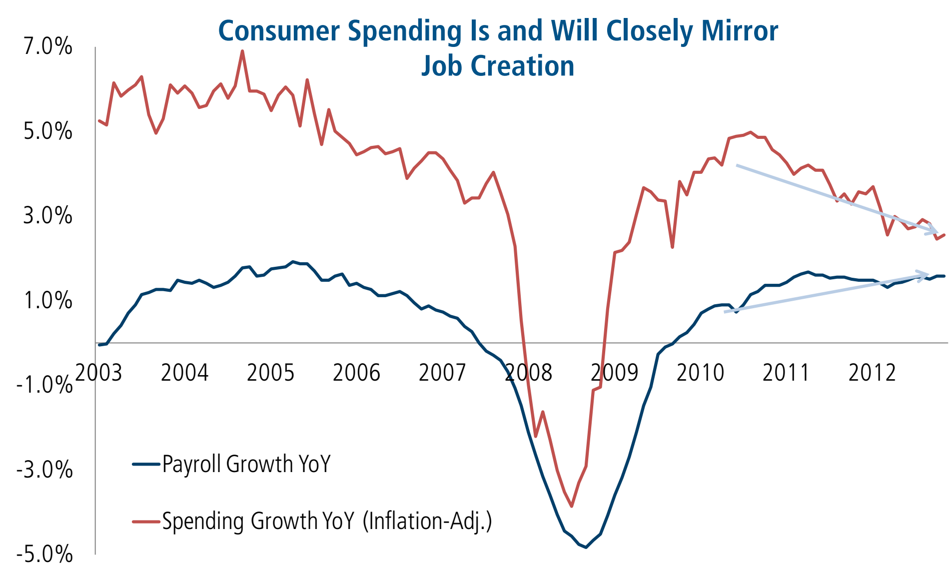
4. Fiscal policy will continue to be contractionary, and Congressional budget debates represent the greatest downside threat to our economic forecasts; the more times Congress plays chicken with the debt ceiling, the greater the probability of a car crash

5. Longer term, the lack of real economic innovation is very troubling, and will serve to constrain economic growth, as well as inflation and interest rates, below its post-World War II average

Consumer Balance Sheets Repaired; All About the Jobs

- **The consumer deleveraging that began in 2008 is nearing its short-term completion, with consumer debt/income ratios stabilizing around 90%**
- **The end of consumer deleveraging means that spending, which accounts for about 70% of the US economy, should more closely track income growth**
- **With wage inflation extremely low, much of this income growth will need to come from continued job creation**
- **We're projecting 180K – 200K monthly rate of job growth for 2014, representing a slight acceleration from 2013's 175 – 185K pace, helped by reduced attrition in state and local government payrolls**





Source: Janney FISR; Federal Reserve Board; Commerce Department; Labor Dept.

The Fiscal Kerfuffle, Round 3

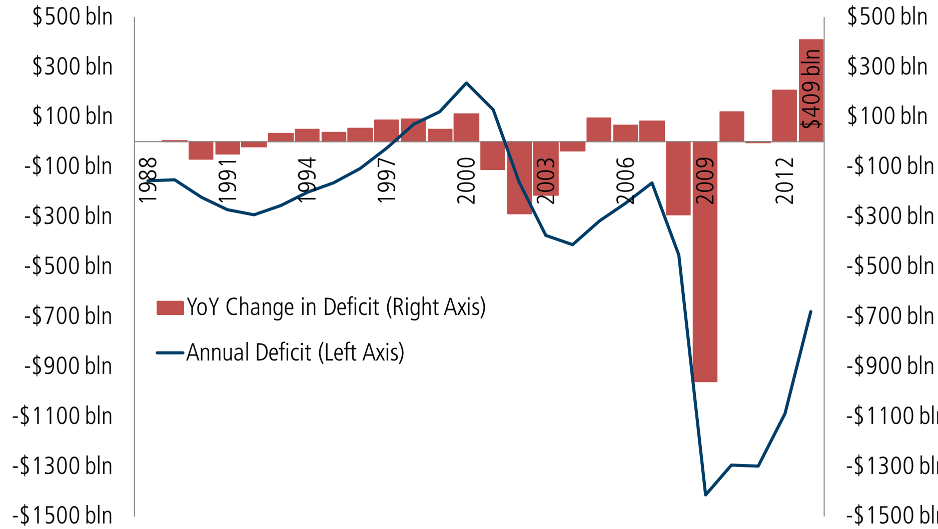
- We cited fiscal risks as one of the greatest problems for the US in 2013; while both the sequester and later the Oct shutdown rattled nerves, they appear to have had surprisingly little broader economic impact

- Consumer confidence dipped in Oct-Nov, but there's no evidence that this weaker confidence has hit spending; moreover, business, judging by the ISM, felt little direct impact

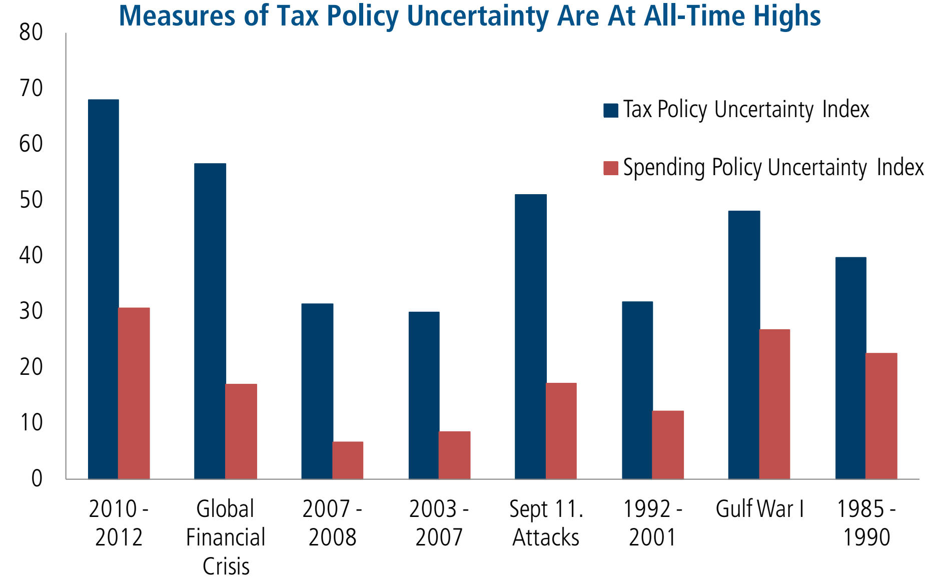
- The real issue is long term uncertainty created by fiscal debates, as that reduces businesses' and households' willingness to invest over the long term

- This lack of investment is and will continue to be one of the biggest long term problems for the US economy, as productivity growth will prove harder to come by in future years and decades

Deficit Fell $409bln in FY2013, Indicative of Less-Stimulative Fiscal Policy



Measures of Tax Policy Uncertainty Are At All-Time Highs

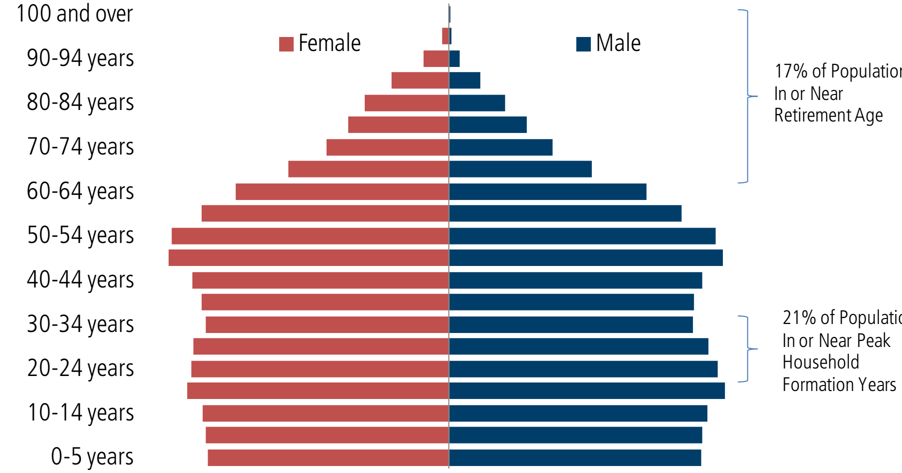


Source: Janney FISR; Treasury Dept.; Access World Newsbank Policy Uncertainty Index

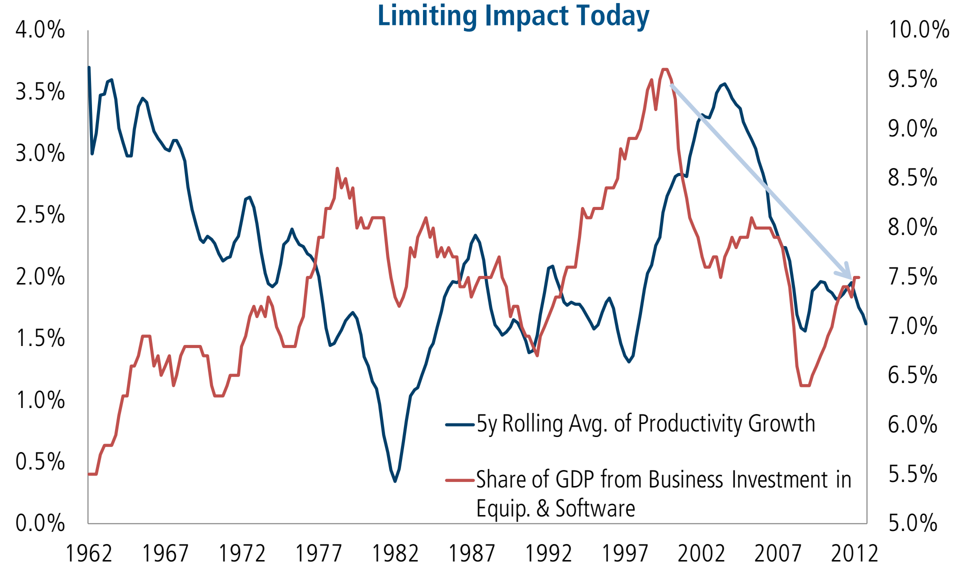
Speed Limits

- **Despite our forecast for stable growth in 2014, there are significant longer term problems which suggest growth won't return to its pre-2008 average**
- **Demographic trends are not particularly favorable, as a large portion of the workforce is beyond its "productivity improving" period, but household formation of millennials in coming years provides an offset**
- **More problematic for the long run is the lack of economic innovation that drove growth in the 1990s (tech innovation) and 2000s (financial innovation); businesses have pulled back materially on long term capex and R&D spending**
- **Lower levels of real investment in the 2000s and today restrict future innovation and act as a speed limit for long term economic growth**

Demographic Profile Poses Challenges, but Millennials Cushion Impact



Decline in Real Investment Beginning in 2002 is Having Productivity-Limiting Impact Today

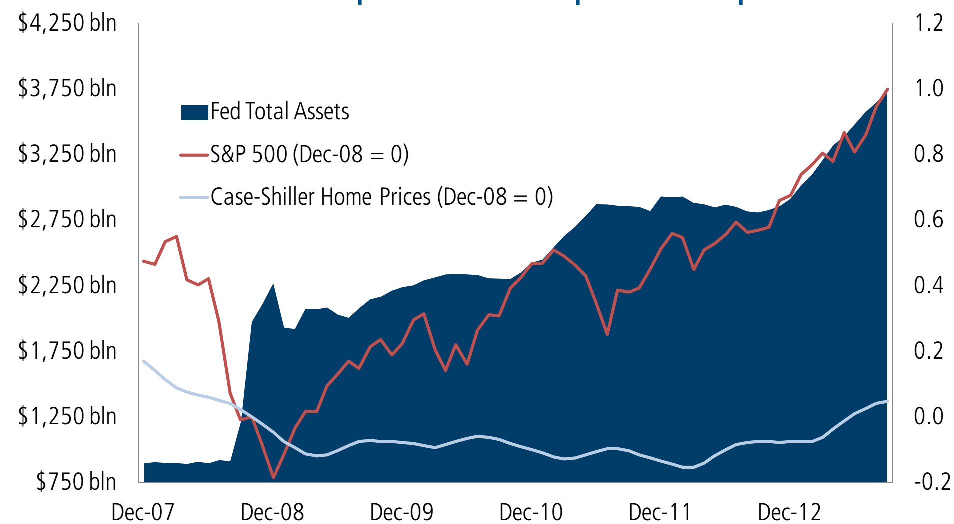


Source: Janney FISR; Census Bureau; Commerce Dept.

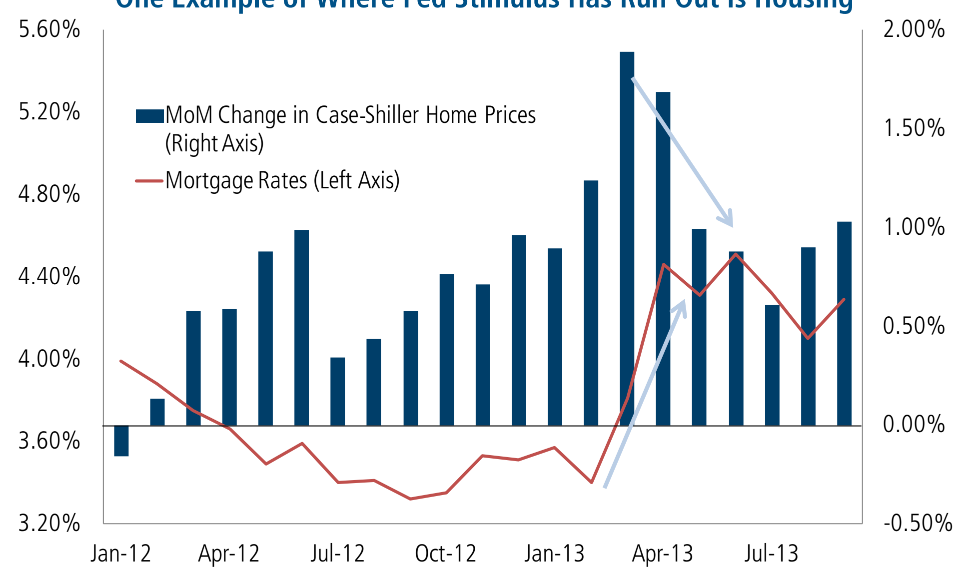
How Much Can Fed Policy Really Do?

- The biggest economic debate of the coming few years will be one about the effectiveness of monetary policy and central bank intervention in stimulating growth
- Recent partial successes in Japan are an encouraging test case
- But if the economic sluggishness is secular and constrained by these "speed limits," all the Fed is doing by keeping rates low is forcing the economy up against its ceiling, which will cause other problems (inflation, asset bubbles)
- Yellen has thus far planted her feet firmly in the pro-policy dirt, suggesting bias towards low rate stimulus for many years to come
- One thing we do know: Fed policy is causing investors to take more risk, and thereby artificially inflating asset prices in the US

Fed Balance Sheet Expansion Pushed Up Value of Liquid Assets



One Example of Where Fed Stimulus Has Run Out is Housing



Source: Janney FISR; Federal Reserve Board; S&P/Case-Shiller; Freddie Mac

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Interest Rates

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Outlook 2014 Rate Forecasts

- **Short Rates:** The Fed is likely to strengthen its low rate pledge along with reductions in longer term bond purchases, thereby largely anchoring the curve. Our forecast for the first fed funds hike isn't until 1Q 2016.

- **Intermediate Duration:** The curve is very steep between 2/5yr points, and the roll down for 5yr bonds makes them very attractive. Interest rates have to rise 45bps/yr to turn total return on 5yr note negative, and carry is much better than in the 2-3yr area.

- **Long End:** The long end of the curve faces further increases in interest rates once the Fed sponsorship wanes. Long term economic speed limits mean that rates are unlikely to return to long term averages, but 3.50% 10yr by 4Q 2014 implies total return on 10yr note of -0.7%.

Interest Rate Strategy: Forecast Detail

Central Bank Rates	Current	2Q 2014	4Q 2014	2Q 2015	4Q 2015
Fed Funds O/N	0.13%	0.13%	0.13%	0.13%	0.13%

Treasury Curve	Current	2Q 2014	4Q 2014	2Q 2015	4Q 2015
3m Bill	0.06%	0.10%	0.11%	0.12%	0.27%
2yr Note	0.30%	0.40%	0.40%	0.69%	0.73%
5yr Note	1.46%	1.60%	1.82%	2.07%	2.19%
10yr Note	2.80%	3.13%	3.42%	3.41%	3.59%
30yr Bond	3.83%	4.22%	4.38%	4.51%	4.75%
2s/10s	250 bps	273 bps	302 bps	272 bps	277 bps
10s/30s	103 bps	109 bps	96 bps	109 bps	116 bps

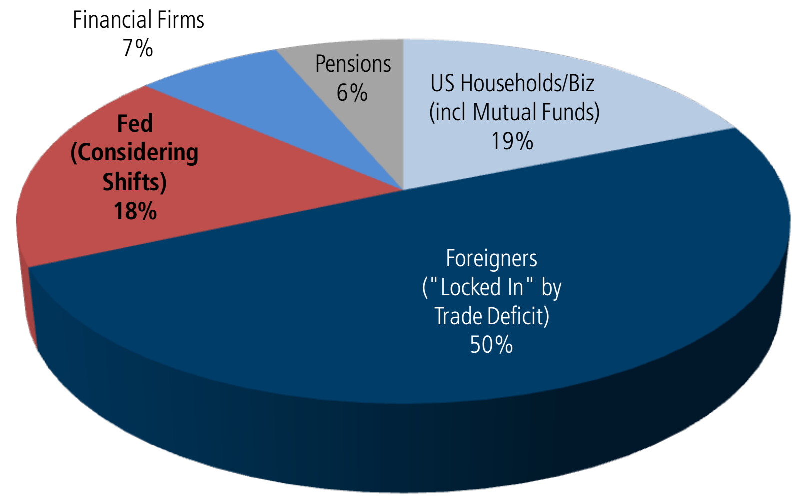
LIBOR/Swaps Curve	Current	2Q 2014	4Q 2014	2Q 2015	4Q 2015
1m LIBOR	0.17%	0.20%	0.21%	0.21%	0.38%
3m LIBOR	0.24%	0.28%	0.29%	0.30%	0.45%
2yr Swap	0.39%	0.52%	0.51%	0.83%	0.87%
10yr Swap	2.86%	3.21%	3.51%	3.54%	3.65%
30yr Swap	3.74%	4.05%	4.17%	4.32%	4.48%

Source: Janney FISR

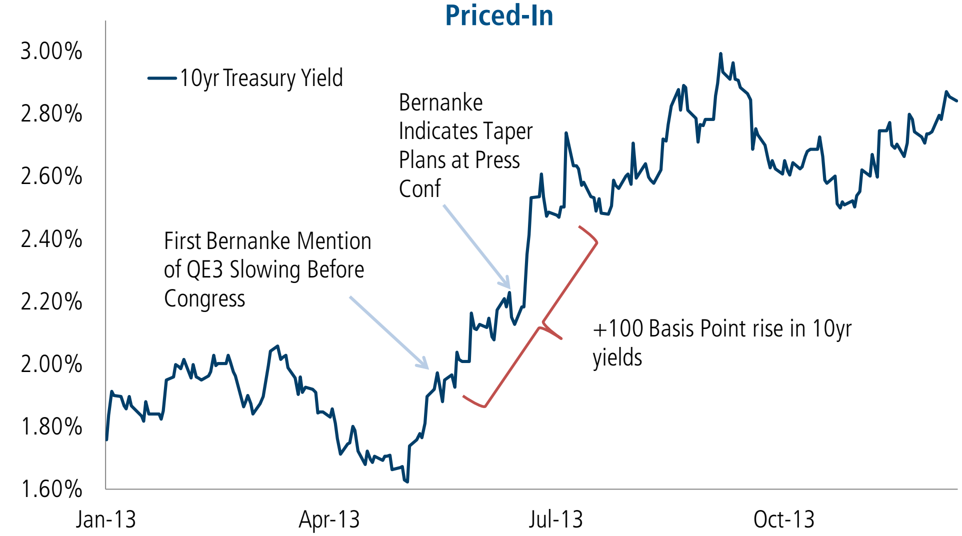
The Only Thing That Really Matters for Bonds: The Fed

- **The Federal Reserve's response function to incoming economic data has been virtually flat for the last five years: no matter the numbers, the Fed just kept easing**
- **Barring a very unlikely economic shift, the Fed will be reducing the pace of easing in 2014, and perhaps even hint at tightening in the years to come**
- **As the market response to recent economic data show, market participants' sole concern is how those data will affect a Yellen Fed's decision-making**
- **We tend to think that a good portion of the initial taper was priced in by the June/July rise in rates from 1.60% – 2.75% ten year yields, as many rates market positions were shaken out by that move, but expect market froth when the Fed actually announces**

Fed Has Grown To Hold Almost One-Fifth of the US Treasury Market



June/July Spike in 10YR Rates Indicates Some Portion of Taper is Priced-In

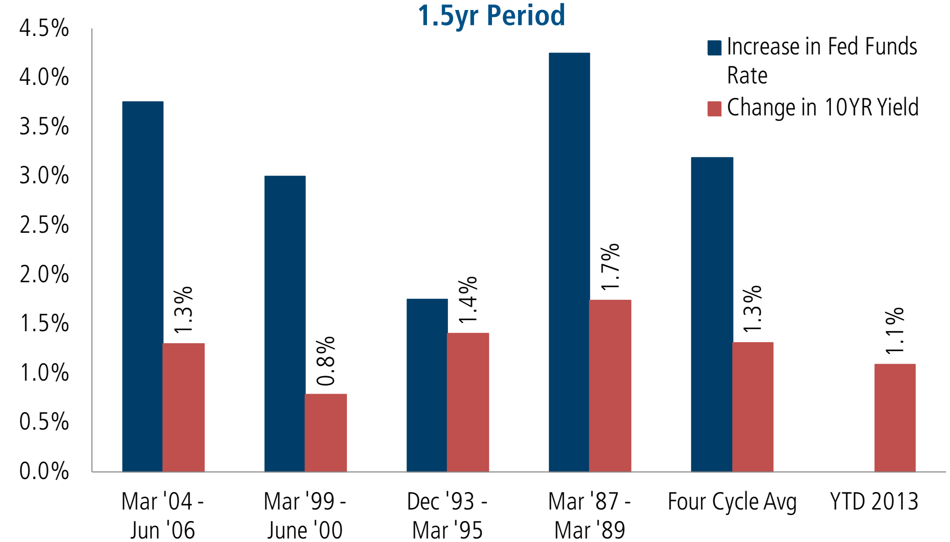


Source: Janney FISR; Federal Reserve Board

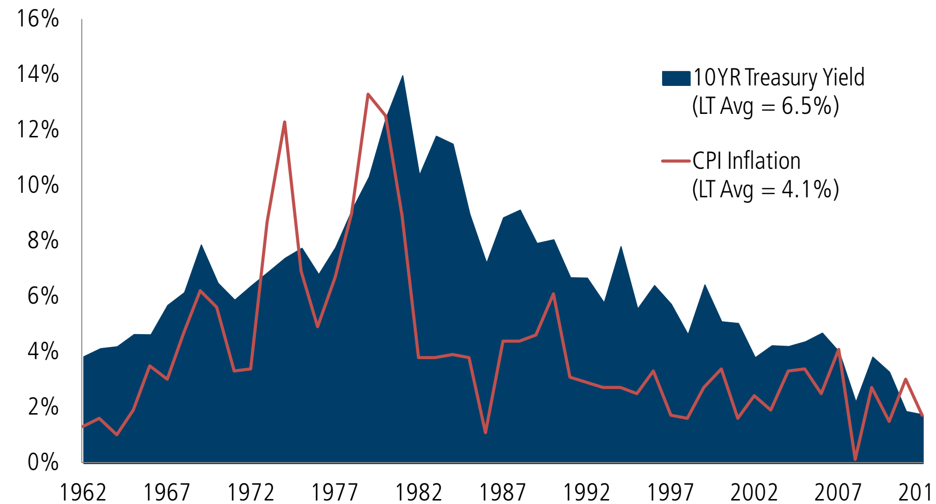
A Return to the Long Run "Normal"

- **With the Fed changing gears, it's our expectation that rates will continue to rise, *BUT* it's not just whether rates rise that matters, but how fast and how far they go**
- **Judging by recent comments, the Fed wants the process of higher rates to be gradual so as to avoid "shocking" the economy, though rate moves are not fully under their control**
- **Longer run, speed limits of economic growth and very benign inflation suggests that the long run level of interest rates is much lower than post-War average**
- **We would peg 4.00 – 4.50% as the settling area for10yr Treasury yields and 5.00 – 5.50% as the settling area for 30yr yields, but it could take until 2016, when the Fed starts hiking short term rates, to see those levels**

Last Four Fed Cycles Saw 10YR Yields Rise Avg of 1.3% Over 1.5yr Period



10YR Treasury Averaged 6.5%, But Inflation is 2% Below Historical Levels

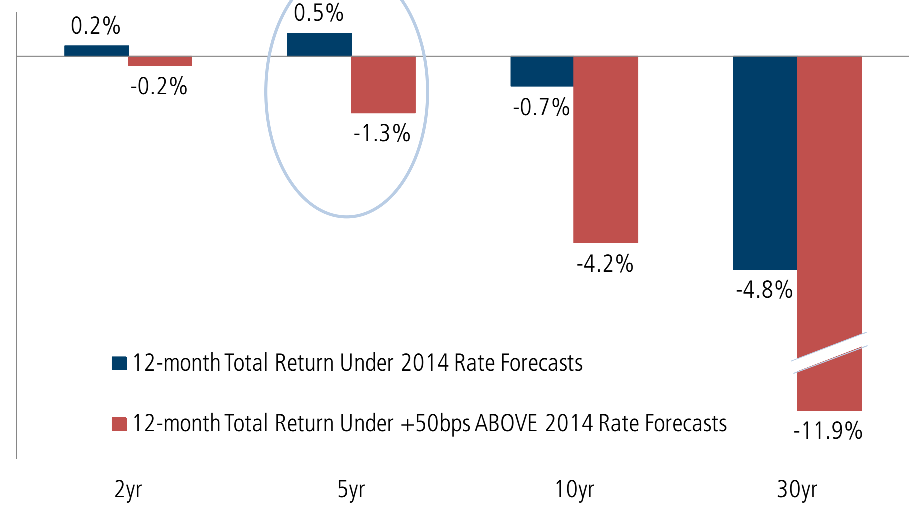


Source: Janney FISR; Labor Dept.

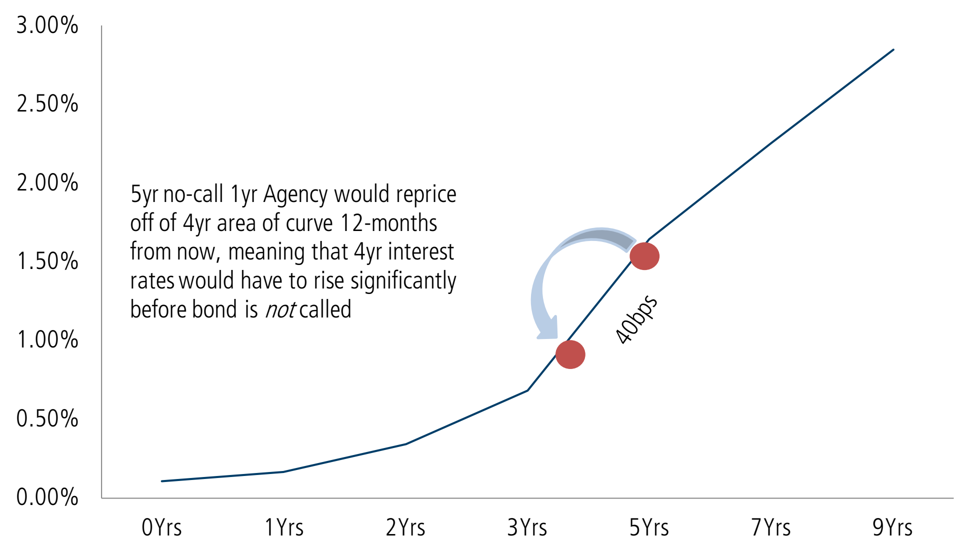
Interest Rate Risk: Where to Be

- **We conducted a total return analysis based on our interest rate forecasts to project returns from various areas of the yield curve**
- **Once again, the 5yr area of the curve is our favorite point to invest, owing largely to the steepness between the 2yr and 5yr points, as well as the overall limited degree of interest rate risk in the 5yr area**
- **While TIPS have value as a long term inflation hedge, we don't view the current market as a good entry point, given how low domestic inflation is and will likely be for several years**
- **5yr callable agencies are a good way to pick up additional carry, as a steep curve on the front end makes calls likely in coming years**
- **Mortgages appear fully valued at this point, however, and are sensitive to Fed QE pullbacks that will likely hit in 2014**

Total Returns Based On Janney Rate Forecasts Recommend 5yr Part of Yield Curve



5YR/1YR Callable Agencies Offer Great 1YR Carry Opportunity



Source: Janney FISR

Key Themes: Credit & Muni Markets

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Tom Kozlik | Director, Municipal Credit Analyst

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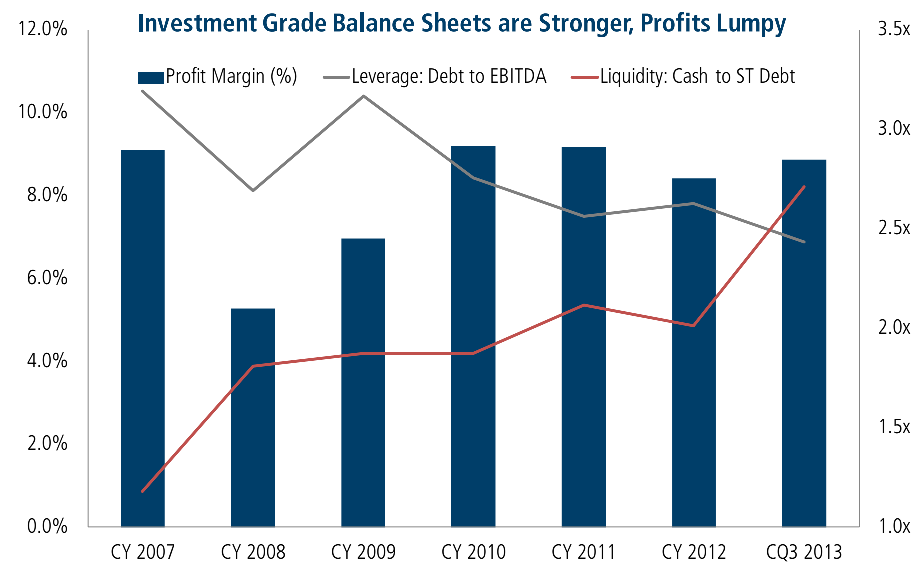
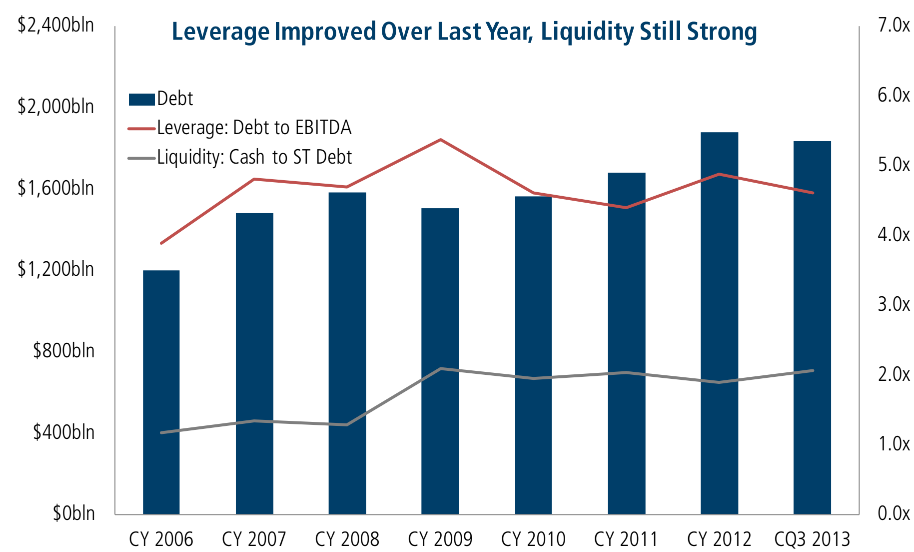
Corporates: General Thoughts

1. **Investors not tied to corporate bond market will continue to look elsewhere for returns**
2. **Market liquidity risk is worth taking, albeit more selectively on a credit-by-credit basis**
3. **Industry Commentary**
   - Cyclical sectors should outperform noncyclical on modest economic improvements
   - Financials may experience some pressures with short-term rate volatility throughout the year
4. **Investment Grade**
   - Triple B corporates remains the area with the most cushion against interest rate risk
   - Staying shorter in may be advantageous in the short run; longer term debt likely to become cheaper
5. **High Yield**
   - Spread differential of higher to lower rated credits may tighten towards 2007 levels on yield-grabbing
   - Possible correction in equities may affect pricing of high yield bonds

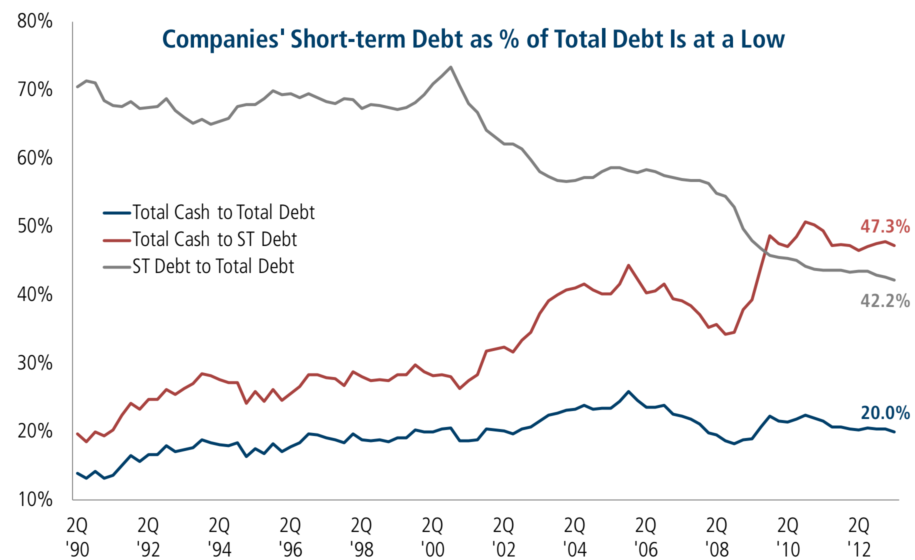


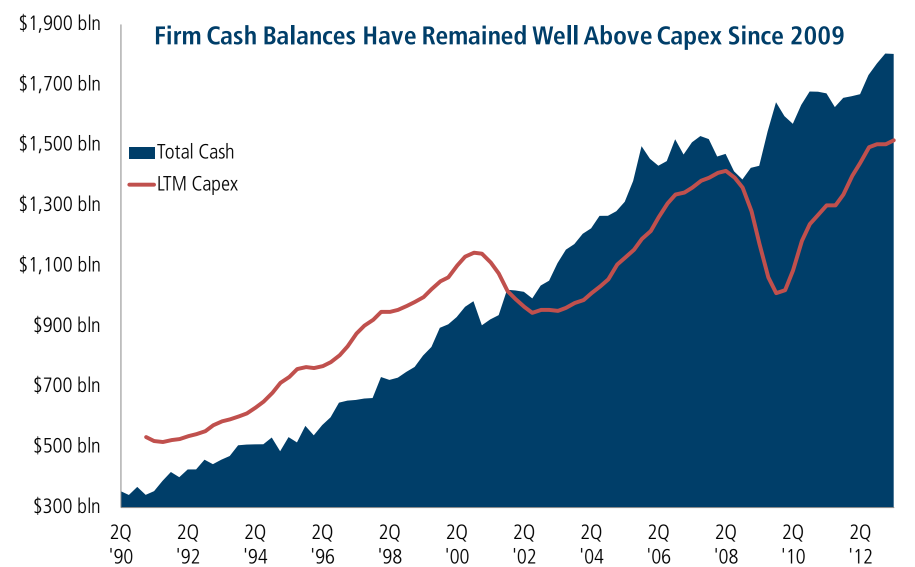


Source: Janney FISR; Citi Indices; Capital IQ; IG and HY defined by S&P ratings

The Question of Business Investment (or Lack Thereof)

- **Companies continue to be cash hoarders as they wait for clearer signs that the economy is improving**
  - Short-term debt to total debt is at a low meaning less near-term risk should capital markets freeze up
  - Cash to short-term debt is near a high, so improved liquidity is building on companies' ability to manage in a downturn
  - Cash to total debt is modestly higher: a more conservative position
- **Although tighter than at the height of the recession, the proportion of capex to cash balances is still lower than historical levels**
- **Firms are opting for "sure thing" cash usage (i.e. dividends, share buybacks) over longer term investment strategies**
  - Lingering uncertainties in Washington not enticing firms to spend
  - M&A activity in terms of volumes for 2013 fell short of Street expectations
  - Recent rally in equities translates to higher company valuations, but also more confidence in the market



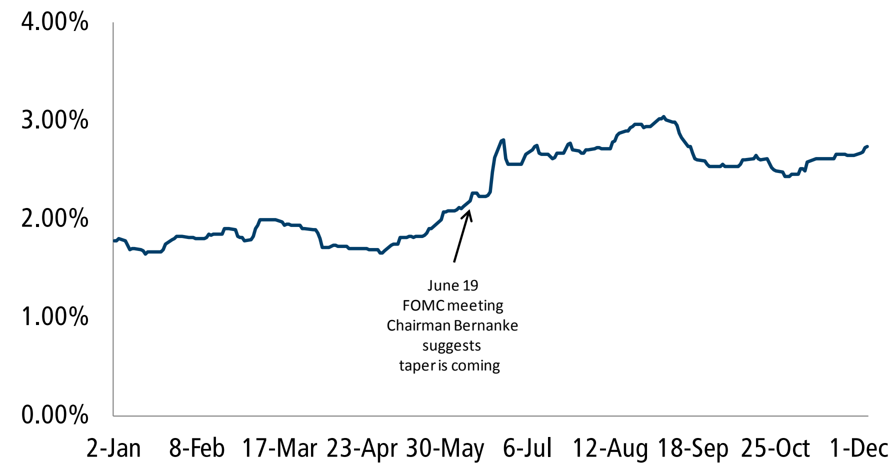


Source: Janney FISR; Federal Reserve as of 09/25/2013

Rising Interest Rates Are a Manageable Challenge

- **Rate increases will be moderate in 2014**
  - The trend is upward but changes will be manageable, although volatility will persist
  - Inflationary expectations, the primary driver of long term interest rates, are low
  - Impact of eventual Fed tapering action is partially built into yields after June bump
  - We expect monetary policy to anchor short term rates near zero through 2015 and into early 2016
- **Manage with duration**
  - We favor the 6 to 14 year range of the yield curve where yield pick up on 5 year extension is strongest
  - Laddered portfolio strategy limits high/low swings from interest rate volatility
  - Premium bonds, particularly if callable, have defensive characteristics in rising rate environments

Much of Upward Rate Adjustment Occurred in June (10yr Tax Free Yield)



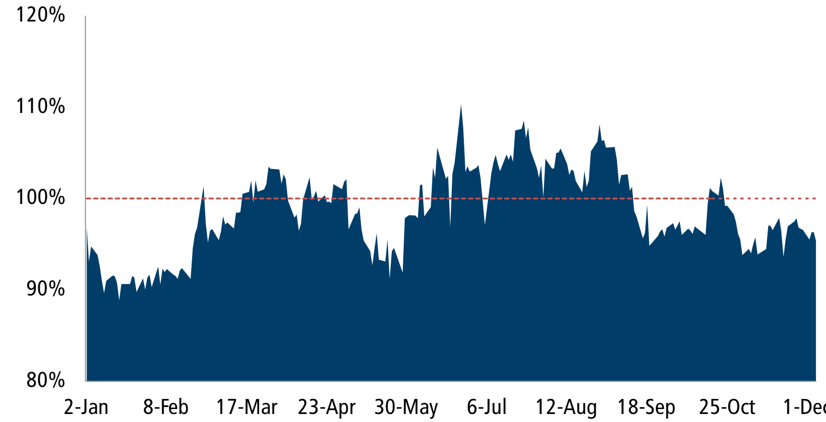
Steepness of The Yield Curve is Concentrated in 6 to 14yr Maturities

Source: Janney FISR, Thomson Reuters MMD

Relative Value of Tax Free Bonds is Strong

- **Ratios**
  - Municipal to Treasury ratios, a key relative value indicator, have dropped from mid year highs
  - The 10 Year M/T ratio was well above average in 2013
    - 2013 average – 98.64%
    - 2010-2013 average – 96.10%
    - 2000-2009 average – 87.70%
  - This is particularly notable since, if new (1-1-13) Medicare Investment Tax is considered, top federal bracket tax rate is highest since 1981
- **Taxable Equivalent Yields**
  - Unlike ratios which compare tax free yields to taxable yields, Taxable Equivalent Yields (TEY) identify the taxable yield needed to match a tax free yield for a specific tax bracket investor
  - For example to match a 4% tax free yield a 35% federal bracket investor would need a 6.54% yield on a taxable corporate bond
  - On a taxable equivalent basis, municipal bonds offer significantly higher yields than like maturity and rating taxable alternatives

M/T Ratios Have Receded from Mid Year Highs (10 year maturities)



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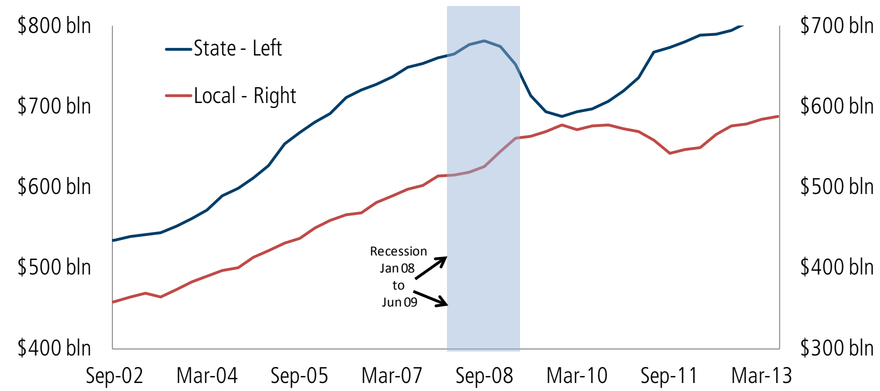
Source: Janney FISR, Thomson Reuters MMD, Internal Revenue Service

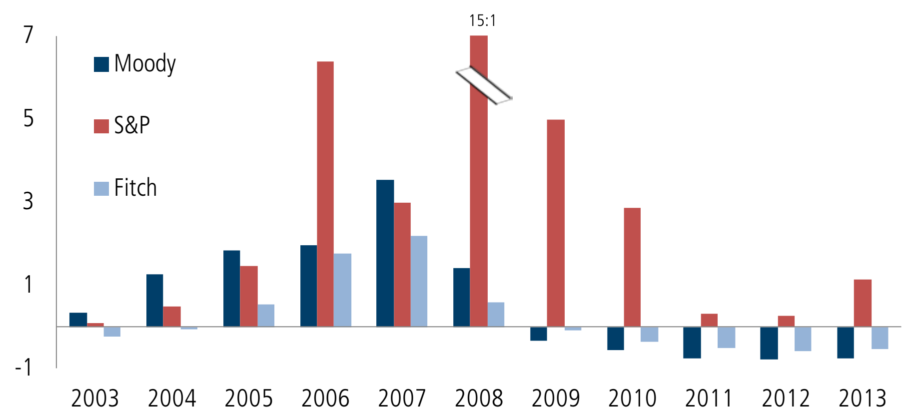
Municipal Credit Conditions are Improving

- **State and Local Revenue Improvement**
  - Sales and income tax revenue, which fell sharply during and after the recession, has largely recovered to exceed pre-recession levels. The pace of recovery has not been consistent in all locations
  - Property taxes, which underlie about 75% of local government tax revenue, have been slower to recover and more spotty than sales and income taxes, but stability is gradually returning
  - The challenge of managing expenses and balancing budgets, as revenue dropped during and following the recession, has well prepared most municipalities and states to manage finances in future slower growth economy
- **Ratings Actions**
  - Moody's revised the outlook on local government debt to stable from negative in December 2013
  - Excepting S&P, the number of rating agency downgrades have exceeded upgrades for 19 consecutive quarters. We believe the trend will reverse, with upgrades matching or exceeding downgrades in 2H 2014

State and Local Tax Revenues Have Recovered to Pre-recession Levels



Moody's and Fitch Downgrades Outpaced Upgrades for 19 Quarters – Net Ratios



Source: Janney FISR, US Census Bureau, Moody's, S&P, Fitch

Appendix 1: Speaker Certification & Disclaimers

Certification & Disclaimers

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Overweight: *Janney FIS expects the target asset class or sector to outperform the comparable benchmark (below) in its asset class in terms of total return*

Marketweight: *Janney FIS expects the target asset class or sector to perform in line with the comparable benchmark (below) in its asset class in terms of total return*

Underweight: *Janney FIS expects the target asset class or sector to underperform the comparable benchmark (below) in its asset class in terms of total return*

Benchmarks

Asset Classes: *Janney FIS ratings for domestic fixed income asset classes including Treasuries, Agencies, Mortgages, Investment Grade Credit, High Yield Credit, and Municipals employ the "Barclay's U.S. Aggregate Bond Market Index" as a benchmark.*

Treasuries: *Janney FIS ratings employ the "Barclay's U.S. Treasury Index" as a benchmark.*

Agencies: *Janney FIS ratings employ the "Barclay's U.S. Agency Index" as a benchmark.*

Mortgages: *Janney FIS ratings employ the "Barclay's U.S. MBS Index" as a benchmark.*

Investment Grade Credit: *Janney FIS ratings employ the "Barclay's U.S. Credit Index" as a benchmark.*

High Yield Credit: *Janney FIS ratings for employ "Barclay's U.S. Corporate High Yield Index" as a benchmark.*

Municipals: *Janney FIS ratings employ the "Barclay's Municipal Bond Index" as a benchmark.*

Analyst Certification

We, Guy LeBas, Alan Schankel, Tom Kozlik, and Jody Lurie, the Primarily Responsible Analysts for this report, hereby certify that all views expressed in this report accurately reflect our personal views about any and all of the subject sectors, industries, securities, and issuers. No part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.

Appendix 2: Additional Credit/Muni Discussion

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A Look Back: Outlook 2013

- **Our 2013 recommendations were based largely on the belief that interest rate risk was the greatest challenge facing the financial markets**
- **Interest rates rose steeply in 2013, with 10yr yields increasing 1.05%, but the bulk of the increase took place in just a few weeks**
- **Economic performance was on the high end of our range forecast, with growth looking to come in 2.2% – 2.4%, though inflation moderated below expectations**
- **Investment grade corporate returns proved disappointing, constrained by the interaction between higher rates and wider spreads in June/July**
- **High yield credit returns were strong as spread compression continued across the ratings spectrum**
- **Municipals' total return performance was negative even though M/T ratios improved, as higher rates on the long end pressured the sector**

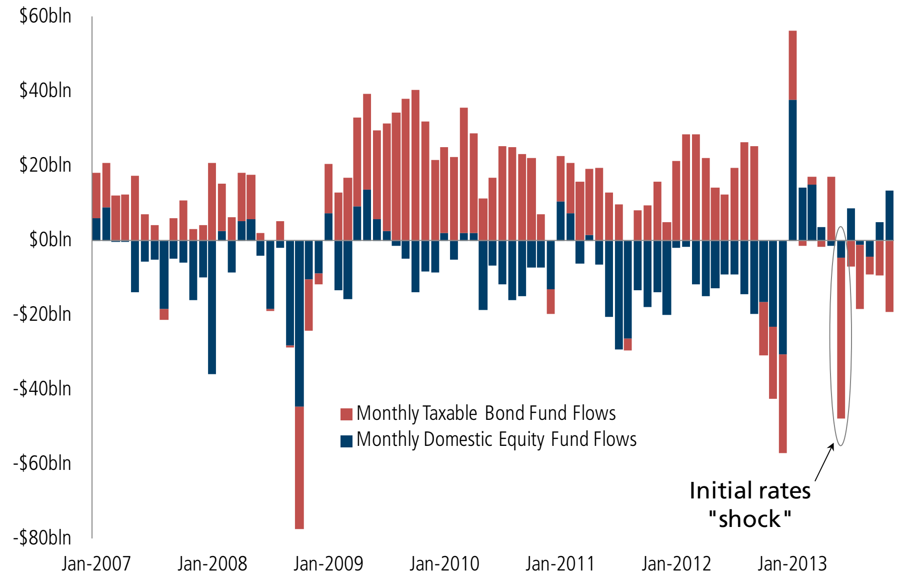
Sector	2013 Outlook	2013 YTD Returns
Treasuries	Underweight	-2.2%
Agencies	Neutral	-1.0%
Agency MBS	Neutral	-1.3%
IG Credit	Overweight	-1.8%
HY Credit	Overweight	6.8%
Municipals*	Overweight	-2.5%
Yield Curve	Moderately Higher	10YR +105bps
	Steeper Curve	2YR +4bps
S&P 500		28.9%

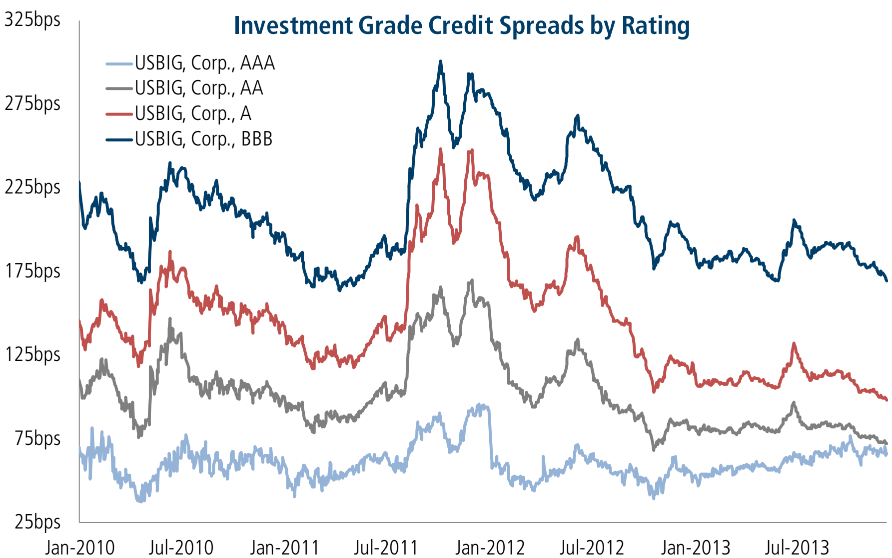
Sector	2013 Outlook	2013 YTD + Proforma
GDP Growth	1.7 - 2.3%	2.2 - 2.4%
Core CPI	1.9 - 2.0%	1.6 - 1.7%
Home Prices	5.0 - 8.0%	15.1 - 16.8%

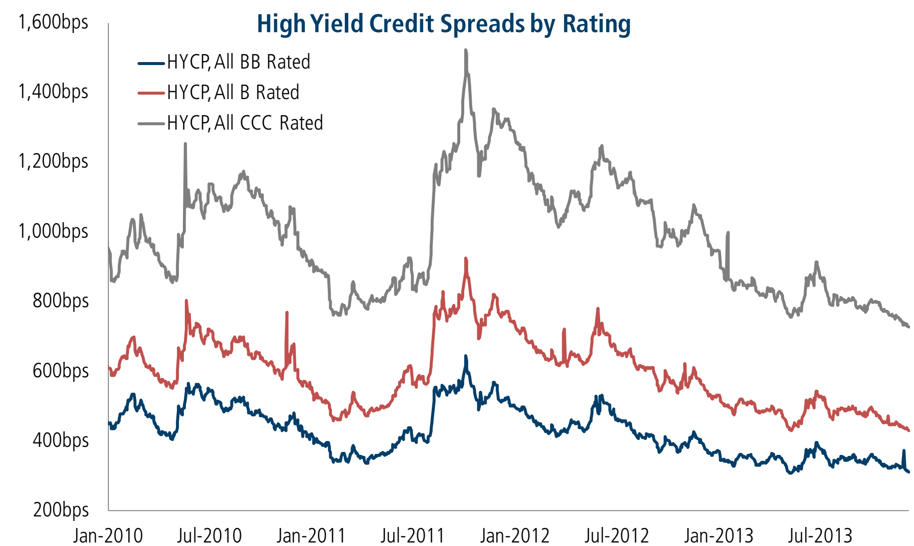
Source: Janney FISR; Citi Indices; BEA; Labor Dept; S&P/Case-Shiller; DJ-UBS Indices; Data a/o Dec 9, 2013 *Excludes effect of tax-exemption

Interest Rate Risk Lingers; Bond Funds Keep Reacting

- **Interest rate risk top-of-mind for 2014**
- **Bond fund activity will cause spurts of short-term volatility in both IG and HY; most recently comprised 17% of total corporate & foreign bonds outstanding[1]**
- **Investors reacting by becoming more selective based on interest rate risk, fundamentals, and relative values**
  - Spreads for higher grade debt have potential to widen
  - Investors continue to flock to lower duration or higher credit risk; potential opportunity in medium-term debt as yield curve steepens
  - Like 2013, equity returns likely to outperform total IG







Source: Janney FISR; ICI; Citi indices; Company reports; Annual maturities only include corporate debentures and IG defined by S&P ratings; (1) Federal Reserve flow of funds data

Investment Grade: Outlook

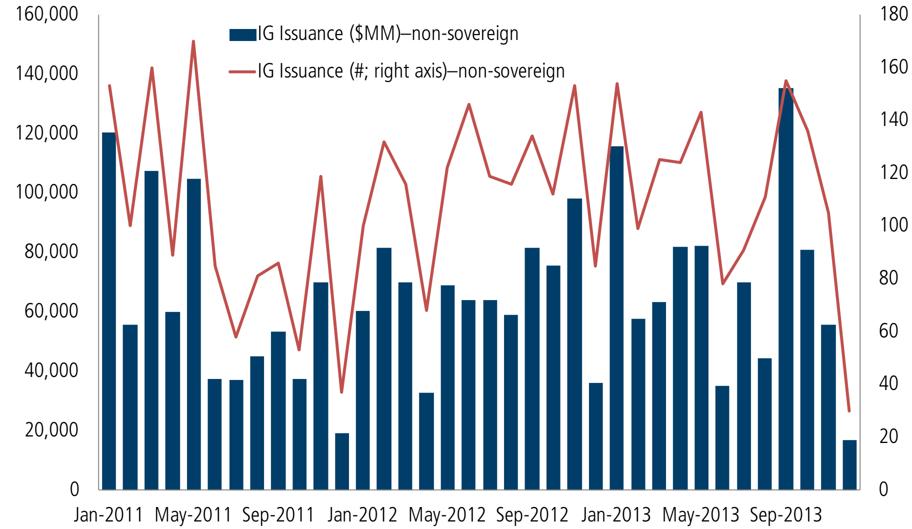
Segment	Investment Grade 2014 vs 2013	Comments
Issuance	Flattish	-4 to 7% as firms continue to issue on thoughts that rates are rising; investor appetite for new bonds remains solid
Spreads	Wider	Threat of Fed taper leading to weaker demand for higher rated debt vs alternative investments
Demand	Flat to Slightly Weaker	A retreat from highest grade and lowest coupon debt on a potential Fed tapering; still wariness on flexible investors' part in moving fully into other asset classes
Credit Quality	Flattish	IG companies benefiting from economic improvements, leading to modestly stronger profits; capex should stay low, leverage flattish, and liquidity robust
Sector Picks	N/A	Still seeing cyclical industries a better buying opportunities than noncyclical; financials to experience some hiccups with short-term rate volatility
Expected Returns	Slightly Stronger	No initial rate "shock" like in June 2013 with a potential for Fed tapering priced in for 2014; fewer areas for ratings upgrades to offset negative effects from a potential rise in interest rates, so more of a carry benefit

Annual Returns	US AAA Rated	US AA Rated	US A Rated	US BBB Rated
2013 YTD	-5.4%	-2.3%	-2.3%	-1.3%
2012	4.1%	6.8%	9.6%	10.4%
2011	12.0%	8.0%	7.4%	8.9%
2010	8.7%	7.7%	8.6%	9.9%
2009	2.1%	6.7%	14.3%	25.0%
2008	5.5%	3.4%	-3.2%	-9.2%
2007	6.9%	5.3%	4.5%	4.8%
2006	4.3%	4.4%	4.3%	4.9%
2005	2.7%	2.2%	2.5%	1.3%

Source: Janney FISR; Citi Indices; Moody's; Annual returns are the sums of daily non-compounded total returns

IG: 2014 New Issues More Modest on "Closing Window"

- **Expect more strategic offerings in 2014 vs 2013**
  - Investors hunting for yield and shorter-term paper
  - Not as much of a "need" for firms to issue
- **Firms likely to use excess cash along with capital markets to refinance 2014-2015 debt maturities**
  - Less attractive cost of capital; refinancing longer-term debt may not be as attractive
- **M&A activity still not completely returned**
  - 2013 volumes below 2012 and 2011, despite a few sizable dollar prices skewing total dollar amount
  - Possibility for some international M&A on slow but improving economics, though firms still skeptical about long-term investments
- **Share buybacks/dividends a likely use for excess cash**



Issuance Use of Proceeds[1]	2013	2012	2011
General Corporate Purpose	44%	45%	42%
Debt Refinancing	38%	37%	38%
Shareholders/Expansion	13%	11%	13%
M&A	4%	6%	6%
Capital/Liquidity	1%	2%	1%

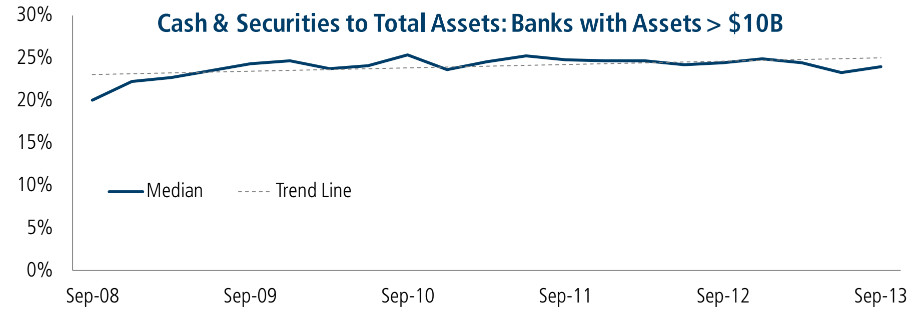
2014 Corporate Bond New Issuance Guidance	High	Low	Comments
IG Mats: 2014	$158 bln	$142 bln	Assume about half will use cash to repay debt
IG Mats: 2015-16	$318 bln	$283 bln	Based on refinancing of >1-year debt in 2013
M&A Fund	$149 bln	$143 bln	Assuming fewer debt-financed M&A
Lev/ Shrhldrs	$329 bln	$293 bln	Expect some growth in share buybacks vs 2013
Total	$955 bln	$861 bln	-4 – 7%

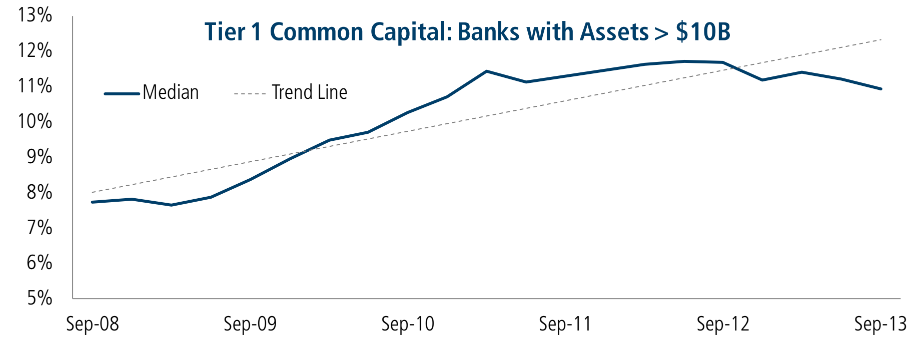
Source: Janney FISR; Capital IQ; Company Reports; TRACE; (1) Excludes issuance that did not provide use of proceeds; Annual maturities only include corporate debentures and IG defined by S&P ratings; New issuance chart data as of 12/06/2013

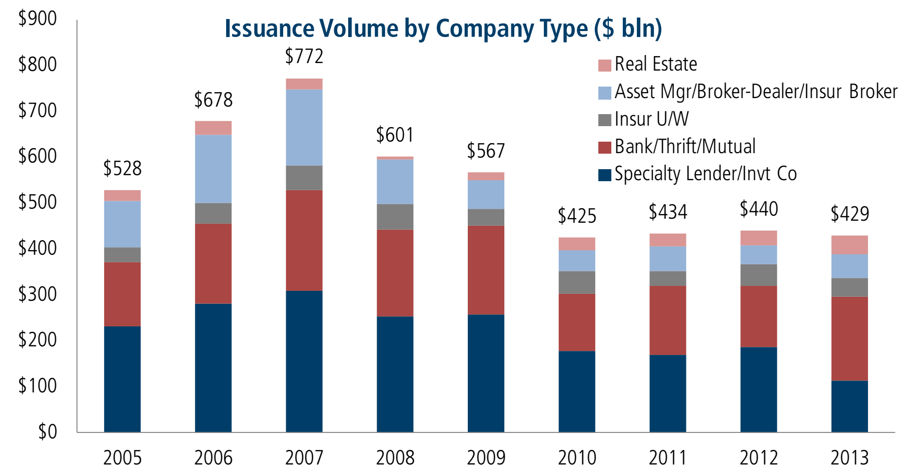
Janney CAPITAL MARKETS

IG: Financial Credit Quality – Rates as Another Hiccup

- **Bank new issuance volumes rose in 2013**
  - Firms took advantage of low rates to bolster profitability while traditional operations lagged
- **Capital adequacy beginning to normalize as banks start to give back to shareholders more actively**
  - Cash balances have stayed elevated, but may begin to shrink on improved global optimism
  - Banks waiting on new regulation to fully take effect
- **Should rate volatility increase in the coming year, loan growth will likely be lumpy**
  - Already saw effects of recent rate shocks on mortgage lending and other product origination
  - Longer term rises in rates should lead to improved profitability, which has lagged in recent years
- **Spreads tightened against nonfinancials in 2H 2013**
  - Expect some shifts in the sector on more clarity about direction or velocity of interest rates





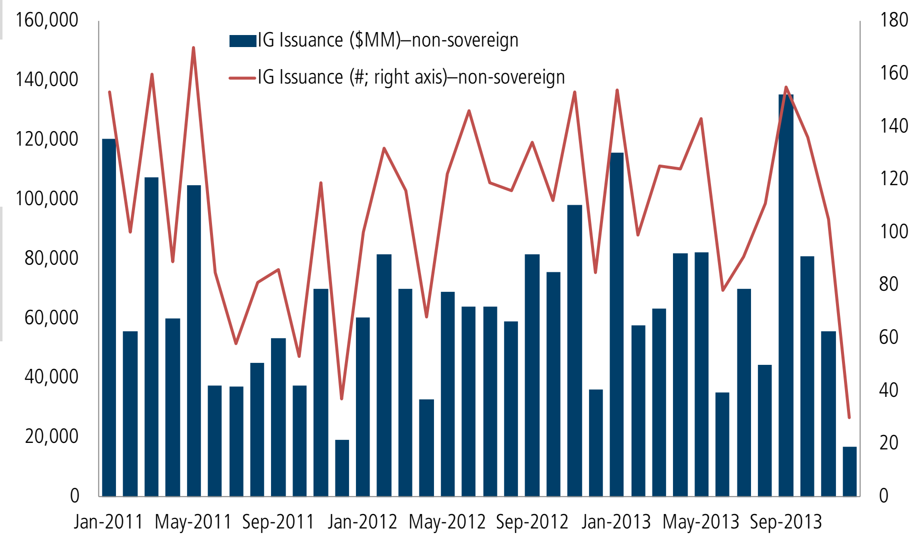


Source: Janney FISR; SNL Financial; Company Reports

High Yield: Outlook

Segment	High Yield 2014 vs 2013	Comments
Issuance	Slightly Lower	Cost of issuance still low vs historical averages; companies have less of a need to issue on lower maturity totals
Spreads	Slightly Wider	Fund outflows would push out spreads from historical lows; potential correction in equities could carry into high yield
Demand	Flattish	Investor appetite will be flattish; yield-seeking mentality combating with less potential for price appreciation
Credit Quality	Flat to Slightly Better	Excess cash, low near-term maturities, and an ability to tap the capital markets for funds will likely offset profit puzzle
Default Rate	Flattish	Expect to stay near 2013 levels as many lower rated firms were able to reduce debt maturities through 2016 by 52% in 2013
Sector Pick	N/A	Energy and cyclical industries will likely offer the best return for risk level once again this year
Expected Returns	Flat to Slightly Weaker	Mid to low single digits; investors feel more comfortable with risk assets, but are not wedded strictly to corporates

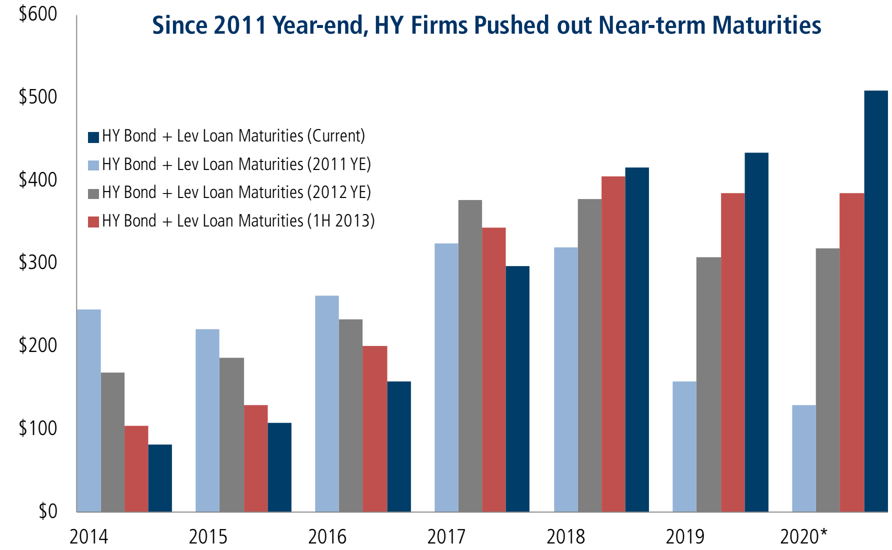
Annual Returns	US BB Rated	US B Rated	US CCC Rated
2013 YTD	3.9%	6.9%	11.7%
2012	12.0%	14.7%	18.4%
2011	7.2%	5.9%	-0.6%
2010	12.6%	12.4%	18.1%
2009	30.1%	37.6%	73.4%
2008	-14.6%	-37.5%	-37.7%
2007	2.4%	2.3%	0.0%
2006	9.4%	11.2%	17.6%
2005	1.4%	4.1%	-3.6%

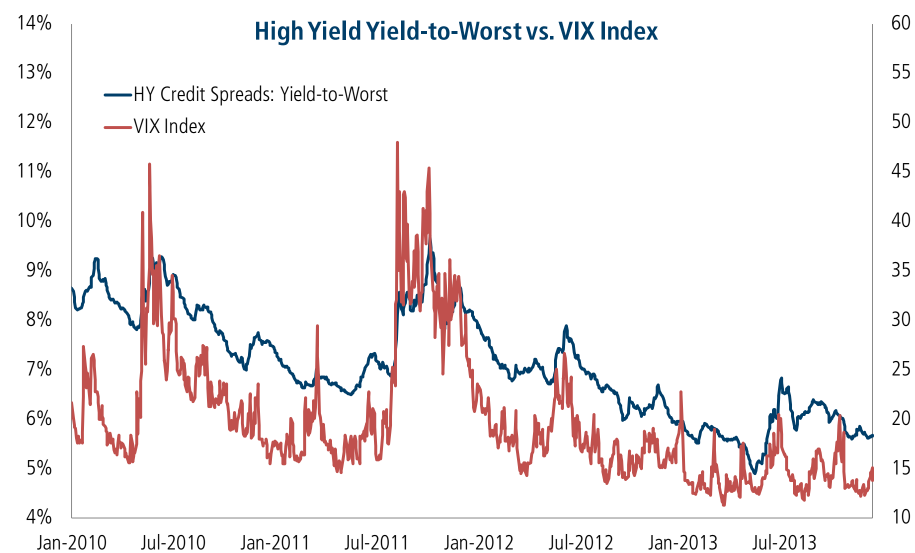


Source: Janney FISR; Capital IQ; Company Reports; Annual returns are the sums of daily non-compounded total returns; New issuance chart data as of 12/06/2013

HY: Credit Strong, Defaults Low; Yields Tied to Equity Volatility

- **Firms took full advantage of the rates environment to bolster cash balances and bring down leverage**
  - Total debt outstanding declined from 2012 levels on some repayment with liquidity on hand
- **Debt outstanding for 2014-2016 dropped meaningfully since year-end 2011**
- **Lack of need to issue will make offerings more modest**
- **Low double B to single B most attractive on price appreciation potentials from better credit quality, but more susceptibility to movements in equities**
  - Credits single B or below shrunk in proportion to amount outstanding in total high yield space(1)
  - EBITDA margins to improve on some economic growth in US/elsewhere; leverage to stay flattish to moderately improved as firms feel less pressure to issue debt
- **High yield primary and secondary markets closely tied to equities; demand for high yield will depend on investors' demand for risk and interest in alternatives**
- **Yield-to-worst is near a 3-year low, and will likely stay near that range or move up slightly with some shifting into alternative products**

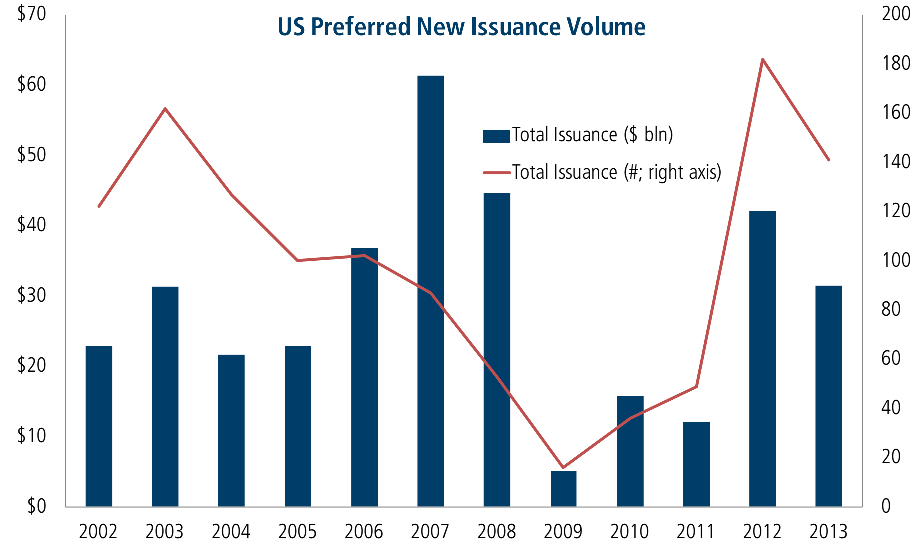


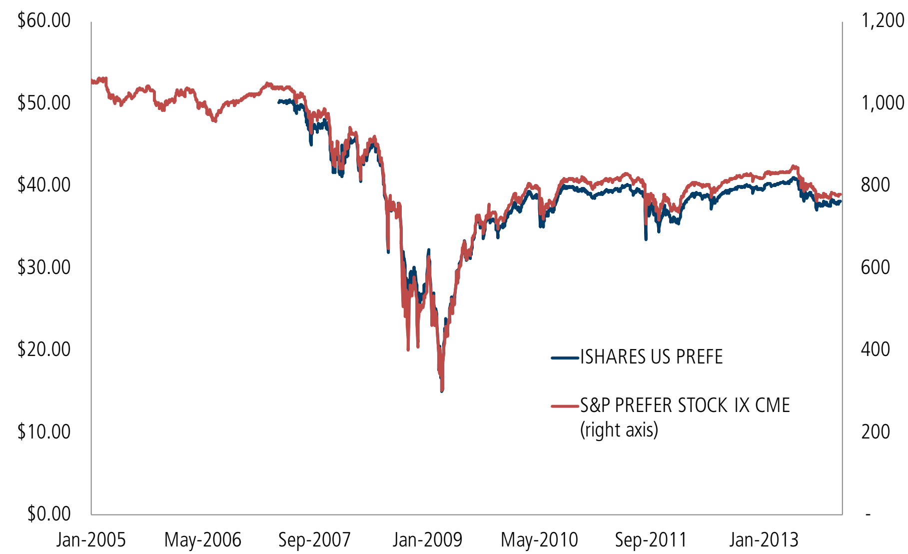


Source: Janney FISR; Capital IQ; S&P LSTA; HY companies are classified per S&P ratings as of latest date; * 2020 data from 2011 YE does not include leverage loan data

Pfds: Trade-off Between Income-Seeking and Lower Duration

- **Retail investors still hungry for yield will continue to look to preferreds**
  - Consciousness about interest rate risk translates to hybrids (fixed-to-floaters, etc.) favored over perpetual securities
  - Medium-term "baby bonds" could comprise a larger portion of new issuance than in 2013 or 2012
- **New issuance likely to remain strong and potentially in line with 2013 levels**
- **Perpetual preferreds likely to depreciate in value as potential for rise in rates lingers in the background**
- **Selectivity based on interest rate risk over credit risk**
- **Returns likely to be break-even after a modest rebound from exaggerated effect based on fears of Fed tapering in mid-2013**



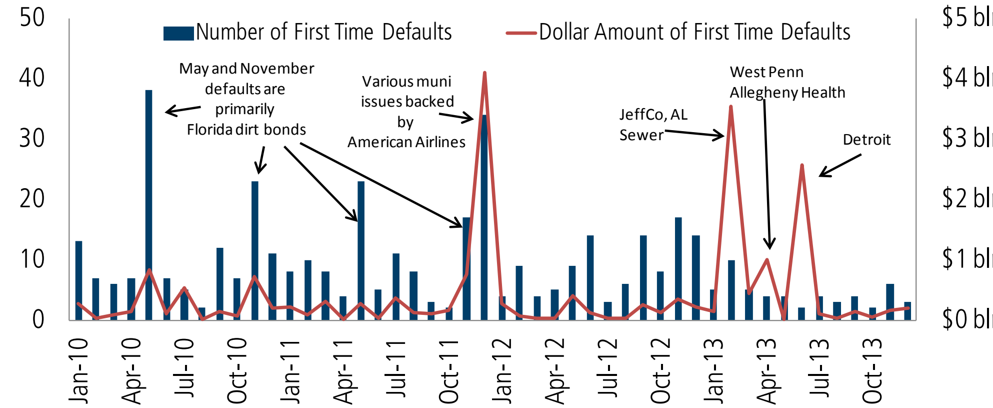


Source: Janney FISR; Capital IQ; SNL Financial; Company Reports; New issuance chart data as of 12/06/2013

Default Trends Improving, Pension Funding Remains a Challenge

- **Defaults Are Fewer**
  - Core municipal sector defaults are fewer, with large 2013 amounts driven by long simmering situations such as Detroit and Jefferson County
  - Real estate backed issues such as non rated Florida Community Development District bonds drove default numbers in 2010 and 2011
- **Underfunded Pensions Continue as Problem**
  - Reforms such as those of Puerto Rico and Illinois are encouraging
  - New GASB standards on accounting and reporting of public pension plans will cast harsher light on underfunding in 2014
    - Unfunded liability to be listed as obligation in financials (like bonds)
    - Lower discount rate to be used on portion of pension liabilities not funded with assets
    - Smoothing eliminated for asset valuations

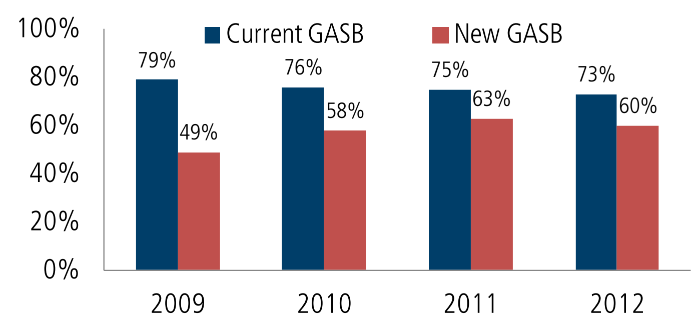
Large 2013 Defaults Trace to Recession and Pre-Recession Roots



Number of First Time Defaults Falling - Large Outliers Skew Dollar Numbers in 2013

Year	Number of Defaults	$ Amount of Defaults	Comments
2010	140	$3.2 bln	Florida dirt bonds in May and November
2011	133	$6.5 bln	Dirt bonds plus AMR in December 2011
2012	107	$1.9 bln	Pace slowing with total under $2 billion
2013	52	$8.4 bln	Long simmering Detroit and Jeffco

State and Local Pension Funding Levels Old GASB vs New GASB



Source: Janney FISR, Detroit Proposal for Creditors June 2013

Credit Precedents Emerging

- **Detroit**
  - Plan of Adjustment (due soon) and subsequent negotiations and bankruptcy court action will have long term influence on municipal credit
  - General obligation debt vs pension liabilities
  - Do GO bonds backed by voter approved taxes have stronger claim than lease backed debt?
  - Can Detroit emerge from bankruptcy with a priority claim on water and sewer revenues, to detriment of bondholders?
- **Harrisburg**
  - A bankruptcy type financial resolution without bankruptcy
  - Bondholders (bond insurers) receive haircut (30%)
  - Major asset sales
  - Balances ongoing fiscal sustainability of community with rights of bondholders, an approach which is also being pursued by Detroit Emergency Manager

Emergency Manager's June Proposal for Creditors Placed GO Debt on Credit Footing Equal to Unfunded Pensions and Debt Without Voter Approval

Detroit - Unsecured Debt	
GO Bonds/Notes	$641 MM
COPs (Service Contract)	$1,452 MM
Unfunded OPEB Liabilities	$5,700 MM
Unfunded Pension Liabilities	$3,500 MM
Other Liabilities	$300 MM
Total Unsecured Liabilities	$11,593 MM

Exchange for $2 billion of limited recourse notes on pro rata basis - ten cents per dollar

Proposal is Favorable for Special Revenue Bonds – But Will Emergency Manager Succeed in Diluting Bondholder Security?

Detroit - Secured Debt	
Sewer Bonds (Sew Revs)	$3,372 MM
Water Bonds (Water Revs)	$2,556 MM
Secured GO (State Aid)	$440 MM
Swap Payments	$879 MM
Other	$97 MM
Total Secured Liabilities	$7,344 MM

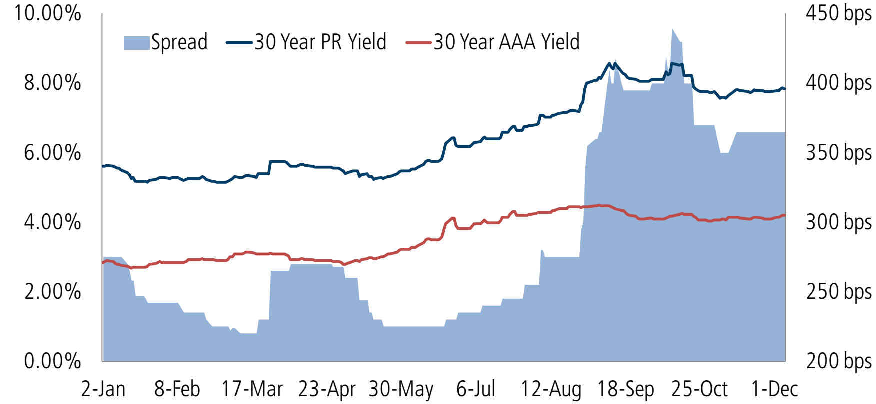
Proposed recoveries close to 100%

Source: Janney FISR, Municipal Market Advisors, Center for Retirement Research, Boston College

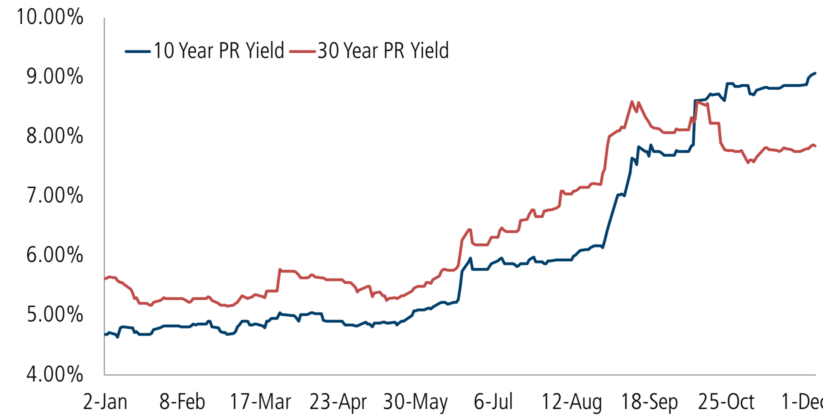
Puerto Rico – Specific and Systemic Risk

- **Significant accomplishments in 2013**
  - Major legislative action to reform largest pension plan and increase revenues to Treasury and public corporations
  - Stronger and more frequent disclosure, although there remains much room for improvement
  - Four months of revenue results indicate potential for realization of on-budget outcome
- **Market access and liquidity remain questionable**
  - Can PR borrow economically (sub 8%?) using COFINA 3rd lien?
  - If no market access in 2014, will liquidity dry up?
- **Default Risk**
  - Although risk is meaningful, we do not see default scenario in near term. Real and perceived risk will recede if fiscal data remains stable
  - Default considerations and hedge fund participation drove dollar price concerns and led to yield curve inversion in October

Spreads Widened After August Barron's Article – Stable But Elevated Recently



Yield Curve Became Inverted in October Due to Default and Related Dollar Price Concerns

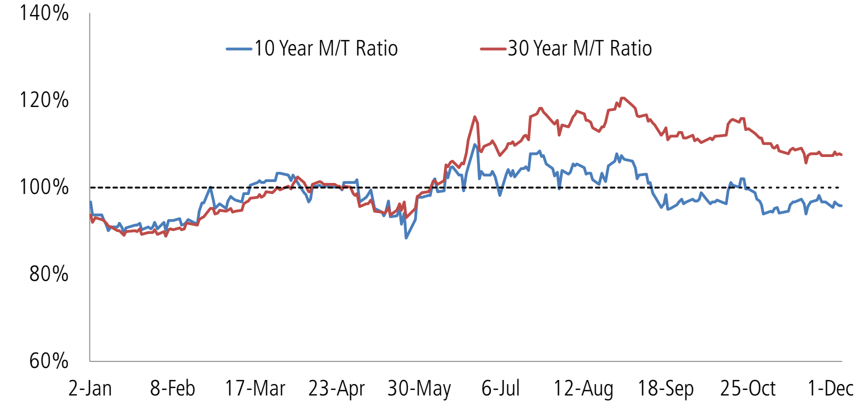


Source: Janney FISR, Thomson Reuters MMD

Other Investor Considerations for 2014

- **The Threat to Tax Exemption**
  - Amidst DC gridlock, potential for near term change to municipal tax exemption has diminished – for now
  - Elevated M/T ratios of recent vintage, with tax free yields nearly equal to taxable yields, seem to discount erosion of exemption
- **Mutual Fund Outflows**
  - Investor redemptions of Municipal Mutual Funds set a record pace in 2013, reflecting concerns about credit (Detroit, Puerto Rico, etc.) as well as the tax exemption
- **Bond Insurance**
  - The entry of Build America Mutual (BAM) into mix increased competition with Assured Guaranty and lowered premiums paid by issuers, but insurance new issue market share remains below 4%
  - Given insurance success stories in Detroit, Harrisburg and California, we believe insurance will gain in popularity with retail investors

M/T Ratios Near or Above 100% Reflect Concerns About Exemption



After a Strong 2013 Start, Mutual Funds Lost $56 bln in Muni Assets

Source: Janney FISR, Thomson Reuters MMD, Investment Company Institute

Appendix 3: Final Certification & Disclaimers

Certification & Disclaimers

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Definition of Ratings
Overweight: *Janney FIS expects the target asset class or sector to outperform the comparable benchmark (below) in its asset class in terms of total return*
Marketweight: *Janney FIS expects the target asset class or sector to perform in line with the comparable benchmark (below) in its asset class in terms of total return*
Underweight: *Janney FIS expects the target asset class or sector to underperform the comparable benchmark (below) in its asset class in terms of total return*

Benchmarks
Asset Classes: *Janney FIS ratings for domestic fixed income asset classes including Treasuries, Agencies, Mortgages, Investment Grade Credit, High Yield Credit, and Municipals employ the "Barclay's U.S. Aggregate Bond Market Index" as a benchmark.*
Treasuries: *Janney FIS ratings employ the "Barclay's U.S. Treasury Index" as a benchmark.*
Agencies: *Janney FIS ratings employ the "Barclay's U.S. Agency Index" as a benchmark.*
Mortgages: *Janney FIS ratings employ the "Barclay's U.S. MBS Index" as a benchmark.*
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Analyst Certification

We, Guy LeBas, Alan Schankel, Tom Kozlik, and Jody Lurie, the Primarily Responsible Analysts for this report, hereby certify that all views expressed in this report accurately reflect our personal views about any and all of the subject sectors, industries, securities, and issuers. No part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.