Stamper Capital & Investments, Inc.

“Focusing on Upside Potential with Downside Protection Since 1995.”

Forgotten Asset Class (Muni's) Offer Best Relative Upside/Downside Characteristics Since 1987 Tops

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By using our normal investment approach of focusing on the relative downside protection and upside potential of different investments that has earned our mutual fund client the highest risk-adjusted ratings from Morningstar for all periods, we have discovered that one fixed income market is extremely compelling versus most other asset classes:

The Muni market is now cheaper relative to U.S. Treasuries <u>than it was at the bond market top in early 1987,</u>

The Muni market is considerably cheaper relative to the U.S. stock market <u>than it was at the stock market top in August 1987.</u>

We verified these facts by looking at the yield of the Bond Buyer 40 (the index the the Municipal Bond Future is based on) as compared to the yield of the U.S. Treasury Long Bond and as compared to the dividend yield of the S&P 500.

We used the following process to discover these compelling relationships:

Bonds are Cheap:

Relative to inflation: It is pretty well known that U.S. Treasuries are cheap versus inflation. Historically, the spread between the yield of the U.S. government long bond and the inflation rate has been about 200 basis points and it is now a much wider 400 or so basis points.

Relative to Stocks: Another measure of the relative attractiveness of bonds is versus stocks. We have graphed the S&P dividend yield divided by the yield of the U.S. Government long bond. On this chart, the lower the number, the better the relative value of U.S. governments in terms of yield and the worse the relative value of stocks in terms of yield - the chart shows that U.S. Treasuries are cheaper (than stocks) than even just before the 1987 stock crash.

Muni's are as attractive to U.S. Treasuries as they get:

The industry standard for evaluating municipal bonds is the relationship of AAA-rated muni yields as a percentage of U.S. Government Long Bond yields. Historically, this relationship has fluctuated between the low 80's and the mid 90's. We have graphed the yield of the Bond Buyer 40 (the index the Municipal Bond Future is based on that is composed of 40 long term, high-quality, tax-exempt general obligation and revenue bonds) as a percentage of U.S. Government Long Bond yields. <u>The ratio now indicates munis are cheaper than 1994 when muni buyers were worried about passage of the flat</u>

tax (which would have erased municipal bonds tax-exempt status) and are the cheapest they have been since before the bond market drop in early 1987.

The Clincher: Muni's represent an exceptional value versus their primary alternative: Stocks.

If bonds are cheap to stocks, and muni's are cheap to bonds, then munis must be very cheap to stocks … and that's what we found out; in fact, we found that muni's offer even considerably more value relative to stocks than right before the 1987 stock crash. We have graphed the yield of the Bond Buyer 40 divided by the dividend yield of the S&P 500 that visually shows this very compelling relationship.

This analysis indicates that municipal bonds, which are a primary investment alternative to stocks for high tax bracket investors, have the most compelling upside potential and downside protection relative to both U.S. governments and stocks in general than prior to disastrous market tops. And, the best thing is that while an investor is hanging out waiting for these relationships to normalize, if they are invested in municipal bonds, they are getting the highest relative yields while they wait.

See "Stocks, Treasuries - For Yield, Munis Beat Them All," from the May, 26, 1999 THE BOND BUYER in our Articles section (http://www.risk-adjusted.com/ExternalArticles.html) for additional information on this topic.
