Stamper Capital & Investments, Inc.

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THE STREET

Meet the Street: Taking the Measure of Muni Bonds

By Yoon Cho | 01-09-2002

Today's MEET THE STREET features Clark Stamper, the portfolio manager for Evergreen High Income Municipal Bond, to find out where he's putting his fund's money and his thoughts on how 2002 will shape up.

Fund tracker Lipper ranked Stamper's fund No. 1 over the three-year period ended Dec. 31, 2001, in the high-yield category. For that period, his fund was up an annualized 3.90%; for the year 2001, it gained 5.31%.

Here he discusses his fund's currently defensive posture and why he's expecting a prolonged U.S. recession.

TSC: How do you assess the investing backdrop against which your fund has performed? Could you talk us through your investing strategy this year?

Stamper: We try to maximize our risk-adjusted performance by focusing on upside potential and downside protection on each investment decision made. We look at characteristics including credit quality, interest rates, coupons and maturity.

Credit quality and yield spread -- the differential between the yields of, say, triple B bonds and triple A bonds -- have been very tight in the muni universe for some time. While we are a high-yield fund, our average credit quality has been quite high. We have raised our average credit rating for the bonds we own from single A-minus a few years ago to double A-minus this year, right before 9/11.

We are defensively structured in terms of credit quality and plan to remain this way for some time. And we continue to seek out opportunistic investments offering attractive deals.

For example, I have bought some bonds backed by USG (USG:NYSE) -- they're in bankruptcy. They're a world-class company but got into trouble because of asbestos litigation. I had bought it before the company went into bankruptcy, and even after the bankruptcy the price was going up. I intended to hold on to these, but after 9/11 we became more defensive, and we sold this one, with some profit.

TSC: How do you play the bond market?

Stamper: We're taking significantly less interest-rate risks than the wider markets. We're also a short-term fund, according to Morningstar. To be in this category, the average duration of coupons needs to be less than 4.5 years.

We own a lot of cushion bonds, big coupon bonds trading to a short call [that protects us if prices drop] . Our income is significantly more than a current coupon bond, which would be a bond trading at par without any special bells and whistles. In other words, we have not been getting much capital appreciation, but it's been more than offset by the huge income we have been earning.

This is a much more defensive and stable posture. We outperform as the market drops due to credit quality or interest rates going up, but we typically underperform as the market rallies.

TSC: What is the typical percentage breakdown of your bond holdings?

Stamper: The dividend yield on average for our fund is 4.73%. That's relatively high -- in the 74th percentile for Lipper's high-yield muni fund category. Now, if you want to make that into pretax equivalents compared with Treasuries, for example, you divide [dividend yield] by 1 minus your tax rate. Say, we use 38.6%.

So, if you divide 4.73% by 1 minus 0.386, you get a 7.7% pretax equivalent. That's a pretty big yield for a fund with AA holding of four-year duration. You compare this with the five-year Treasuries, which yield only about 3.62%. So our fund is offering 408 basis points more than the Treasuries market.

An average muni bond is only about $10 million to $15 million in size. But there are a huge number of them. This allows for different kinds of opportunity. So we are scouring the market everyday. We have over 460 bond positions in our fund right now. We're highly diversified and are in all states.

One thing to remember is that bonds are forced to [a given level] by the coupon and maturity and the calls; and that their downside and upside characteristics change depending on the price and where the relative investments are. And these are what we focus on constantly.

TSC: What are the high-quality bonds you're looking at? Any particular states?

Stamper: I am looking at single A or better. There are two types of munis: One is a real muni, which is a bond issued to finance a sewer system, say. The other type is the industrial revenue bond, which is backed by a corporation, whether in utilities, health care, etc. These are the type of bonds I specialize in, and our fund owns a lot of these.

Our portfolio consists of 8% in generic bonds -- general obligation bonds, which are backed by the taxing power of the city -- and the rest in industrial revenue bonds, with

22% in health care, 11% in housing, 12% in utilities, 17% in similar revenue bonds. We like health care here.

TSC: What's your outlook for 2002?

Stamper: I think that we're going into a prolonged recession here. I used to work in the junk-bond taxable market. The spreads started widening in 1998. And those credit spreads -- the difference of the yield between AAA and junk bonds -- have become wider than they ever were in the last recession. Also, Greenspan has lowered rates 10 times without very much success.

The tech boom, in hindsight, was a huge misallocation of resources. The Internet may have increased productivity, but this might also be contributing to deflationary pressures, which were reflected in the big drop in the producer price index. We have also been seeing huge drops in rental prices and increasing vacancies.

I also look at Japan where the yield curve is essentially zero, but still their economy is having many problems. All of this leads me to think we're heading for a pretty nasty time ahead.

I believe over the long run, interest rates -- especially on the long end -- will be drifting upward. I am in the minority for believing that. It has to do with the dollar. I believe that there will be some shift out of the dollar and into the euro, and perhaps into the yen. When this happens, people are usually selling bonds. And this will help push the rates up.

We might also see this when we have stimulus programs to reignite the economy, and we'll definitely see a decrease in tax revenue, which will lead to more issuance of bonds, not less.

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