From: JP Turner & Co. LLC <mblock@jpturner.com>
Subject: August Letter of the Month
Reply: mblock@jpturner.com

Having trouble viewing this email? Click here

Letter of the Month

Defaults & the Muni Bond Market: What Investors Should Know About the Detroit Bankruptcy Filing

Dear Michael,

If you've been keeping up with the news, you know that on July 18, 2013, the city of Detroit filed for Chapter 9 protection in the largest bankruptcy filing in U.S. history. The city is seeking to restructure nearly $20 billion in unsecured debt to many groups of creditors, including bondholders, vendors, and city employees. Detroit's bankruptcy was not unexpected. The city has had troubled finances for many years and a number of factors have brought Detroit to this point, including: a shrunken tax base, overwhelming city healthcare and pension costs, corruption, budget deficits, and repeated borrowing efforts.[i]

As part of its bankruptcy process, Detroit has defaulted on unsecured bonds, but continues to make principal and interest payments on secured bonds, such as its water and sewage bond issues, which are secured by revenues from those services.

It's natural for investors and bondholders to have questions about how such a large municipal bankruptcy and debt default may affect their financial picture. I wanted to provide some information and guidance in putting this default in a larger context.

Should Investors Worry About Detroit's Bankruptcy?

In short, probably not. I am still are confident of the role municipal bonds can play in a well-diversified portfolio of stocks, bonds, and other investment types for some clients.

While I will continue to monitor the ongoing bankruptcy negotiations, I am not unduly worried about the effect a single bankruptcy will have on investors for the following reasons:

- Municipal bond defaults are rare. According to default statistics kept by Moody's rating agency, the default rate of A-rated bonds after three years is just 0.01%, or only 1 in 10,000 bond issues. In contrast, AAA-rated corporate bonds have a default risk of 0.50% after 10 years, meaning approximately 50 bond issues in every 10,000 default.[ii]

- Detroit bond obligations represent an extremely small fraction of the overall muni bond market. According to a Vanguard report, Detroit bond debt represents just 0.05% of the municipal bond market, meaning that most bondholders will not be affected by the default.[iii]

- Some Detroit bonds are insured, and insured bondholders will suffer no loss of principal or interest payments should the city fail to honor its obligations. Historically, municipal defaults have led to periods of increased demand for bond insurance and investors may see an uptick in the number of insured bond offerings in the near future.[iv]

How do I know if my bonds are affected by a Bankruptcy or default?

Bondholders will be notified directly, or through their financial representative if their issuer files for bankruptcy or goes into default.

Ask us if you have any questions about your bonds.

What This Means for Investors

In the short term, interest rates may rise for new municipal bonds since investors perceive their risk to be greater in the wake of high profile bankruptcies. If interest rates rise, investors may also experience some price volatility in municipal bonds, but that will only affect investors who choose to buy or sell their bonds on the open market. Holders of existing municipal bonds who keep their bonds until maturity will not be affected by changes in bond prices.

The municipal bond market will be paying attention to the Detroit bankruptcy process as courts determine whether or not holders of general obligation bonds stand higher in precedence to other creditors such as city workers. Traditionally, general obligation bondholders have been given precedence over other creditors in bankruptcy processes and a change in this arrangement may have ripple effects in the overall bond market.

While no one can foresee exactly what will happen, I believe that while the number of municipal bankruptcies and bond defaults may rise from historically low levels, they should remain very infrequent and unlikely to affect the overall municipal bond market over the long term. The vast majority of municipal bonds should continue to make payments to bondholders in a timely fashion and I urge my clients not to put too much stock in the headlines surrounding a few defaults.

I hope you've found this letter educational and reassuring. If you have any questions about municipal defaults and how they may affect your personal financial situation, please reach out and let us know; we would be happy to discuss your concerns. As always, it is my sincere pleasure to be of service.

Securities offered through J.P. Turner & Company, LLC Member SIPC

Investment advice and financial planning offered through J.P. Turner & Company Capital Management, LLC.

Because market and economic conditions are subject to rapid change, the analysis and opinions provided are valid only as of the date of this letter, and may change without notice. The commentary does not provide a complete analysis of every material fact regarding any country, market, strategy, industry, asset class or security. An assessment of a particular country, market, security, investment, asset class or strategy may change without notice and is not intended as an investment recommendation nor does it constitute investment advice.

All investments involve risks, including possible loss of principal. Diversification and asset allocation do not guarantee positive results. Bond prices generally move in the opposite direction of interest rates. Thus, as the prices of bonds in an investment portfolio adjust to a rise in interest rates, the value of the portfolio may decline. Changes in the credit rating of a bond, or in the credit rating or financial strength of a bond's issuer, insurer or guarantor, may affect the bond's value. Legislative or economic conditions could affect an issuer's ability to make payments of principal and/ or interest.

Bonds sold prior to maturity may be worth more or less than the original cost. Municipal bonds may subject investors to the Alternative Minimum Tax (AMT). Municipal bonds are usually exempt from state and local taxes, though discount bonds may be subject to capital gains tax.

B/D does not provide tax or legal advice. We suggest that you discuss your specific situation with a qualified tax or legal advisor.

Investing in municipal bonds for the purpose of generating tax-exempt income may not be appropriate for investors in all tax brackets.

Bonds sold prior to maturity may be worth more or less than the original cost. Interest may be subject to state and local taxes. Also some issues may be subject to the alternative minimum tax.

Corporate bonds are considered higher risk than government bonds but normally offer a higher yield and are subject to market, interest rate and credit risk as well as additional risks based on the quality of issuer coupon rate, price, yield, maturity and redemption features.

Diversification and asset allocation do not guarantee positive results. Loss, including loss of principal may result.

An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong. An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

Although the opinions expressed are based upon assumptions believed to be reliable there is no guarantee they will come to pass. The information may change at any time due to market or other conditions.

These are the views of Platinum Advisor Marketing Strategies, LLC, and not necessarily those of the named representative, Broker dealer or Investment Advisor, and should not be construed as investment advice. Neither the named representative nor the named Broker dealer or Investment Advisor gives tax or legal advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. Please consult your financial advisor for further information.

By clicking on these links, you will leave our server, as they are located on another server. We have not independently verified the information available through this link. The link is provided to you as a matter of interest. Please click on the links below to leave and proceed to the selected site.

[i] http://www.nytimes.com/2013/07/19/us/detroit-files-for-bankruptcy.html?pagewanted=all&_r=0

[ii] http://www.bnymellonwealthmanagement.com/Resources/documents/PerspectivesDocs/Muni_Bond_Defaults.pdf

[iii] https://advisors.vanguard.com/VGApp/iip/site/advisor/research/article/ArticleTemplate.xhtml?iigbundle=IWE_InvComDespiteDetroit&sub=1610177121&st=R&oeaut=aDgSddhlZX

[iv] http://www.ft.com/intl/cms/s/0/595985b6-012b-11e3-8918-00144feab7de.html#axzz2c4SwpASJ

Send to a Friend | Visit My Site | Email Me

V. Michael Greben
JP Turner & Co. LLC
10451 Mill Run Circle
Suite 205
Owings Mills, MD 21117
Main Office: 410-356-0111
Toll Free: 888-356-5221
Fax: 410-356-3250
mgreben@jpturner.com
http://www.michaelgreben.com

Securities offered through J.P. Turner & Company, LLC Member SIPC. Investment advice and financial planning offered through J.P. Turner & Company Capital Management, LLC.