

Trading Efficiency

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C.W. HENDERSON

& ASSOCIATES, INC.

INVESTMENT COUNSELORS SPECIALIZING
IN TAX-EXEMPT MUNICIPAL SECURITIES

The existence of thousands of municipal securities with varying coupons, maturities, calls and other structural features provide an array of potential bond purchases for investors seeking tax-exempt income to select from. Credit quality variations, issue size and the frequency that an issuer comes to market influence the trading characteristics of specific bonds. State income taxation represents an additional factor in the relative valuation of individual securities.

Discerning value in this complex environment requires focused attention and trading acumen. The C.W. Henderson professional trading staff is adept in this process and continually reviews the slate of weekly new issues and available securities in the secondary market to find attractively priced bonds that meet our credit and structural criteria. The Firm's security selection process focuses on four primary factors: high credit quality (review and approval of all credits by the research group); good liquidity characteristics; a security structure that fits one of the strategies employed in the construction of client portfolios; and attractive relative value.

The C.W. Henderson trading group implements the Firm's active management process by purchasing and selling securities on a daily basis with the objectives of aligning portfolios with the Firm's strategic outlook, attaining best execution and enhancing portfolio value and returns. Tax efficiency is a central feature of the Firm's trading activity. Turnover is high when rates are rising and capital losses can be harvested and low when rates are declining. A few examples of significant value added trades executed over the past few years are detailed below.

High Coupon Short Call Bonds

November 2011

- Purchase of 130 million California Economic Development Revenue 4% bonds due July 1, 2016. The bonds were purchased at 0.93% yield to the July 1, 2012 par call, (3.52% yield to maturity). Bonds maturing in mid July 2012 at that time were yielding 0.22%. The bonds were not called at the first call date and remained outstanding for close to two additional months until they were called on August 24, 2012. The return for the approximate nine month holding period was 1.476% in an environment where nine month securities were yielding 23 basis points.

April 2011

- Purchase of 4 million Aaa/AAA Massachusetts Water Pollution Abatement 5% bonds due August 1, 2021 priced at 0.95% to the August 1, 2012 par call (4.37% yield to maturity). Comparable bonds maturing in August 2012 were yielding 0.39%. A partial call retired bonds in August 2013 resulting in a holding period return of 2.65%. Additional bonds were called on August 1, 2014. The holding period return for these securities was 3.32%. Of the initial 4 million block, 1.65 million remain outstanding.

October 2013

- Purchase of 1 million Massachusetts Water Pollution Trust (Aaa/AAA) 5.25% bonds due 8/1/2015 at 0.20% yield to the 2/1/2014 call. Bonds not called until 5/26/2014 resulting in a 2.98% holding period return when comparable yields were 0.15%.

Bonds Refunded After Purchase

June 2013

- Purchase of 2.72 million State of Ohio 5% bonds due 5/01/2022 at 1.02% yield to 2016 par call (market at 0.60%). Bonds refunded 5/01/2014. Yield to call falls to 0.35%. Client holding period return of 1.61%.

May 2014

- Purchase of 1.67 million Missouri Highway revenue bonds due 5/01/2022 at 0.48% to 2016 call. Bonds refunded shortly after purchase. Sold bonds on June 5, 2014 at 0.28% yield to refunded date, a 0.29% price increase on the two year security in eight days – double digit annualized return.

Purchase of an Underpriced Security

May 2014

- Purchase of Fort Wayne, IN School Building Corp. 5% bonds due 7/15/2027 at 3.07% yield to 2024 par call. Bonds sold 6/10/2014 at 2.93% yield. Price gain of 1.23 points in 27 days. The ten year AAA municipal yield had risen by two basis points during this period and the ten year Treasury rate was unchanged.

Sales of Securities Not Meeting Credit or Structure Criteria

May 2013

- Expeditious sale of Detroit Water 5.25% bonds due 7/01/2025. Inherited with new account in spring of 2013. Position sold at 3.75% yield, dollar price 110.38. Three weeks later bonds traded near par.

March 2011

- Bids sought for block of Moreno Valley, CA Unified School Dist. (A/AA) 5.25% bonds due 8/01/2019 on January 28, 2011. (Bond structure did not fit with CWH strategies.) Received a high bid of 100.34 which was deemed too low. Partial sale on 2/14/11 at 106.103 using Municenter. Additional Municenter sale at 107.232.
- Numerous sales of inherited Puerto Rico securities. Holdings of Puerto Rico bonds in new accounts that are funded with existing securities have always been liquidated as soon as practical. Many liquidated bonds are now trading thirty to forty points lower after being severely downgraded by the rating agencies.

Tax Loss Harvesting Trade

July 2013

- Sale of Fullerton, CA UTGO 5% bonds due 8/01/2028 (Aa2/AA) at 3.82% yield to 2023 par call. Generated a \$67,140 loss per million par that offset capital gains in other sectors of clients' overall portfolios. Replaced with Aa2/AA Huntington Beach, CA Unified High School Dist. UTGO 5% bonds due 8/01/2027, also structured with a 2023 par call.

Sales of low quality securities that subsequently experience severe price erosion and tax benefits accruing from tax loss harvesting as illustrated in the last two sections add meaningfully to portfolio integrity and tax efficiency. The beneficial impact of this trading activity is not included in reported returns.