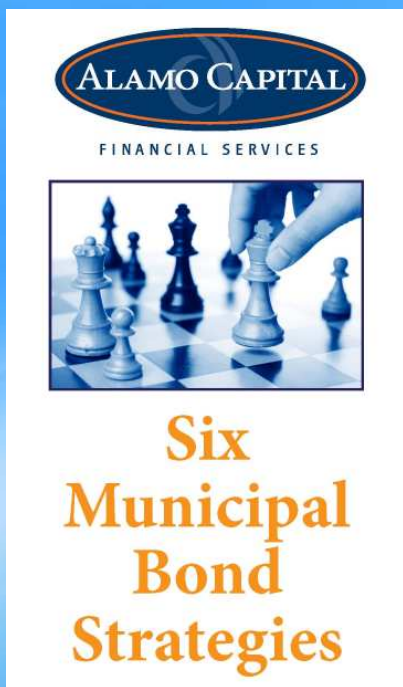




FINANCIAL SERVICES

# BOND BASICS WITH BILL MULLALLY

## TODAY AND TOMORROW'S FIXED INCOME INVESTOR



*(Brochure in your folder)*

# ALAMO CAPITAL

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# WHAT ARE MUNICIPAL BONDS

Municipal Bonds are debt instruments of Cities, Counties, and States.

- Bonds are issued to finance schools, highways, hospitals, water systems, sewer systems, libraries, universities and other projects for public use.

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# TYPES OF MUNICIPAL BONDS

- **General Obligations** are an ad valorem taxing power for the municipality to raise taxes to meet debt service. (G.O.'s) are voted on and are a priority payment from the general fund of the municipality.
- **Revenue Bonds** are paid from a pledge from the revenue source.
- **Certificates of Participation** are a promise to pay and are subject to annual appropriation from the general fund budget of the Municipality.



# CALIFORNIA MUNICIPAL BOND TAXABLE EQUIVALENT YIELDS

- Example: A 5.00% tax free municipal yield is equivalent to a taxable yield of 8.60%\* if you are in the highest Federal and State tax bracket.

\*Assuming:  
\$1MM+ (Joint Income)  
Federal Tax Rate 35%  
CA State Tax Rate 10.30%



## WHAT DOES IT MEAN WHEN I AM QUOTED A YIELD?

- Coupon is what you get paid every six months.
- Current yield is the coupon divided by the dollar price.
- Yield to call is what the yield would produce to the worst case call feature on the bonds.
- Tax exempt yields are usually stated in terms of yield to maturity. (The yield is expressed at an annual rate)



# UNDERSTANDING CREDIT RATINGS

CREDIT RISK	MOODY'S	S&P	FITCH
PRIME	Aaa	AAA	AAA
EXCELLENT	Aa	AA	AA
UPPER MEDIUM	A	A	A
LOWER MEDIUM	Baa	BBB	BBB
<i>SPECULATIVE</i>	<i>Ba</i>	<i>BB</i>	<i>BB</i>
<i>VERY SPECULATIVE</i>	<i>B, caa</i>	<i>B, CCC, CC</i>	<i>B, CCC, CC, C</i>
<i>DEFAULT</i>	<i>Ca, C</i>	<i>D</i>	<i>DDD, DD, D</i>



## UNDERSTAND MARKET RISK

- If held to maturity then the rate of return is what was locked in at the purchase date.
- If traded prior to maturity date the market price is subject to current interest rates at the time of the trade.
- Inverse relationship between yield and dollar price.
- Yield goes up ~ dollar price goes down.
- Dollar price goes up ~ yield goes down.



# UNDERSTANDING CALLS

Many municipal bonds have a call feature that allows the issuer to call the bonds prior to the maturity date.

- Optional call
- Extraordinary call
- Sinking fund call





# FUNDAMENTAL # 1

## Long-Term Strategy

(20+ year maturity)

- Advantages: Normally Long-Term bonds have the highest yield.
- Disadvantages: Price volatility.
- Why people do it: Income, speculation. Planning for future events. Possible tax advantages.



## FUNDAMENTAL #2

### Intermediate Strategy

(10-20 year maturity)

- Advantages: Less price volatility.
- Disadvantages: Yields are not as high as longer maturities.
- Why people do it: Maturities are selected to conform to future needs.



# FUNDAMENTAL #3

## Short-term strategy

(1-5 year maturity)

- Advantages: Liquidity and minimum price volatility.
- Disadvantages: Usually has the lowest yield.
- Why people do it: Liquidity of principal and minimum exposure of interest rate fluctuations.



# FUNDAMENTAL #4

## Premium Strategy

(purchase price higher than par)

- Advantages: Greater income with less volatility.
- Disadvantages: Higher dollar price.
- Why people do it: Greater income with higher yield and lower volatility.

*(When compared to discounted bonds)*



## FUNDAMENTAL #5

# Discount Strategy

(purchase price lower than par)

- Advantages: Buy more bonds for your money. If interest rates decline, discount bonds have the highest potential to increase in value.
- Disadvantages: Current yield may be lower than current coupon bonds. If interest rates rise, discount bonds have the greatest price volatility. Potential capital gain taxes.
- Why people do it: Do not need all current income now. Greatest upside potential if playing interest rates.



# FUNDAMENTAL #6

## Laddered Portfolio Strategy

- Advantages: Hedges you against interest rate fluctuations and provides diversification of maturity, price, geographic location, type, and credit quality.
- Disadvantage: Average yield is less when compared to only investing in long-term bonds.
- Why people do it: Investors who are unsure about where interest rates will go, but want a steady income, take advantage of laddered portfolios.



# CALIFORNIA MUNICIPAL BONDS

## Bonds Secured by the State

- Governor Jerry Brown's objective is to balance the budget.
- The State's economy and revenues are gradually improving.
- General obligation bond payments come second only to school obligations.
- Lease and appropriation backed debt is next in line.



# CALIFORNIA MUNICIPAL BONDS

## Bonds Secured by Local Governments

- Most California residents continue to pay their property taxes.
- Most California residents continue to pay their utility bills.
- The economic downturn has adversely impacted some issuers.
- Most issuers are making the difficult decisions necessary to balance budgets and fulfill debt service obligations.

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# CALIFORNIA MUNICIPAL BONDS

## Looking Ahead

- The art of politics is compromise.
- Fulfilling all debt service obligations is essential to the well being of State and local governments.
- A consensus needs to be reached to fix deficit problems.
- Progress is slowly being made.



# OTHER FIXED INCOME PRODUCTS

- Mortgage Backed Securities\*
- Government Agencies\* (Bullets, Callables & Step-Up coupon bonds)
- Corporate Bonds\*
- Treasuries (Bills, Notes & Bonds)
- Certificates of Deposit

\*Taxable



# BOND ON-LINE TRADING SYSTEM



- Access and search for over 25,000 fixed income offerings.
- Receive bids on your bonds.
- Create reports.
- Build laddered portfolios.
- View Bond details.

*View the brochure in your bag for more details about BOLTS.*



## DISCUSSION

- As you can see from this presentation, Municipal Bonds are complex and vary greatly.
- Understanding the fundamentals is key to investing in bonds.
- Having a bond professional to help navigate the bond market is essential.



# QUESTIONS & ANSWERS

Please feel free to contact a Bond Professional at  
Alamo Capital

(877) 68-ALAMO

(877) 682-5266

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We thank you for your time.



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