



ColumbiaManagementSM

Key Investment Themes for 2012: Tax-Exempt Income

Hello, my name is Chad Farrington, Portfolio Manager and Director of Municipal Credit at Columbia Management. In this video, I'd like to discuss the municipal bond market, which is one of our key investment themes for 2012.

Recent changes to the tax exempt market have placed greater importance on credit research and active management.

First, there's the loss of bond insurance, which had removed credit risk in the past, but now means investors must understand underlying credit characteristics of the thousands of different investment options in the market.

Then there's the credibility of the rating agencies which took a hit in the subprime mortgage crisis and which has been further questioned with recent mass upgrades among certain sectors of the municipal market — all at a time when state and local budgets are under extreme pressure.

While we agree that default experience will likely increase from the very low default rates of the past 40 years, we don't believe that there are any systemic risks similar to what occurred in the mortgage market. Instead, defaults will likely occur within risky sectors of the market or among entities with already weak credit profiles that were compounded by economic weakness.

The municipal market is a disaggregated market with thousands of borrowers, and that makes generalizations difficult.

The Columbia Management municipal credit team continuously monitors the credit factors of each individual borrower. We review management capabilities, the local economic climate, debt burden, and financial flexibility in an effort to uncover potential credit risks. Since we don't expect widespread defaults, our research focuses instead on identifying value and avoiding rating downgrades, especially given changes in rating agency methodology that took place in 2010.

What scenarios might lead us to alter our view of municipal credit strength? If courts became less willing to enforce legal protections for bondholders; if markets became less disciplined in penalizing distressed credits; or if state intervention became less likely.

So far, none of these scenarios has emerged, and the inherent strengths of many tax exempt issuers supports our belief that credit defaults will remain rare among local municipal credits.

With the recent move higher in rates, we believe tax exempt bonds present an attractive opportunity relative to other fixed income options. Investors in Columbia Management tax exempt funds can benefit from a centralized trading desk that offers best execution and a team of nine credit analysts that provides security selection insight. These attributes are especially important in an over-the-counter market like the municipal market.

While the tax exempt market has its challenges, we believe it's an opportune time to invest. Current yields are attractive thanks in part to fear surrounding credit risk. Therefore, active management in making security selection decisions is critical. The municipal credit team at Columbia Management has the tools and tenure to navigate through today's market turmoil. We offer a diversified mix of funds with competitive long-term track records and the benefit of experienced management, trading, and research teams.

Thanks for listening, and for additional information, be sure to visit the Market Insights section of our web site: columbiamanagement.com

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