Municipal Market Comments

ASCENT Investment Partners

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from Montage Investments

Missouri Remains Strong Despite Moody's Negative Outlook

State of Missouri	Ratings	Outlooks
General Obligation bonds	Aaa / AAA / AAA	negative / stable / stable
Appropriation bonds	Aa1 / AA+ / AA+	negative / stable / stable
Missouri Direct Deposite School Enhancement Program	Aa1/AA+/nr	stable* / stable / na

* pending expected adjustment to negative
Sources: FitchRatings; Moody's; S&P

On February 5, Moody's changed the rating outlooks for 22 'Aaa' rated issuers, including the State of Missouri, to negative due to their "indirect linkages to the U.S. government." Moody's currently has a negative outlook on its rating for the U.S., and it views the issuers it revised as being tied closely enough to the credit health of the U.S. that they cannot be rated higher than the U.S. itself. If the rating of the U.S. is lowered, Moody's believes that there would be negative impacts on these issuers as well, so would lower their ratings in tandem.

We do not believe that Moody's action reflects any increase in the credit risk of Missouri bonds. Rather, we think that Moody's current approach – benchmarking issuers annually against median levels of federal dependence and adjusting outlooks based on the results – introduces an unnecessary degree of volatility into state and local issuer rating outlooks that doesn't reflect true changes in investor credit risk.

Moody's rating action affects not only the rating of Missouri general obligation (GO) bonds, but also the ratings of all state and agency bonds secured by state appropriations. These bonds are typically rated one notch below the state's GO rating and will move in tandem with the state's rating. Also affected, though not yet adjusted by Moody's, are the outlooks for Missouri local school district bonds enhanced through the Missouri Direct Deposit Program.

Missouri's strong credit quality is supported by:

- A strong and diverse economic base with economic centers in both St. Louis and Kansas City;
- Strong budget management with a Constitutional requirement to make mid-year budget adjustments to correct imbalances;

- Good financial management practices, including a Constitutional requirement to maintain a budget reserve fund;
- A moderately low debt burden with Constitutional limits on the issuance of state General Obligation debt; and
- Funding levels for pensions and retiree health care obligations that are above the median level for states.

Immediately after it changed its outlook on the U.S. to negative in July 2011, Moody's began reviewing all of its 'Aaa' rated municipal issuers to determine if they were sufficiently dependent on the activity of the federal government that their ratings should be linked to the U.S. government's rating. Moody's looked at factors like: the concentration of federal employment in the state, federal procurement contracts as a percentage of state GDP and Medicaid's percentage of the state's budget to determine which issuers were most vulnerable to changes in the U.S. credit rating. In its initial review, Moody's placed the outlook of five states (Maryland, New Mexico, South Carolina, Tennessee and Virginia) and 161 local governments on negative outlook.

Moody's reviewed each of these issuers and reversed itself on many of them in December 2011, revising two states (South Carolina and Tennessee) and 119 local governments back to stable. Moody's current action is the result of its annual review of the linkage between state and local governments and the U.S. government. Moody's added Missouri to its list of indirectly linked states due to the state's federal procurement (5.3% as a percentage of total state GDP) and Medicaid spending (33.1% as a percentage of total state general fund revenues) being slightly higher than Moody's threshold levels of 5.1% and 32.8%, respectively. Unlike the other three states currently carrying negative outlooks, none of Missouri's measures were far beyond Moody's threshold and they had not exceeded those threshold levels prior to the current review. Furthermore, as state budgets adjust to revenue growth and program changes, these measures will undoubtedly rise and fall over time. While we would view an established trend of above-average dependence on federal spending as a credit factor worth closely following, we would also expect conservative states like Missouri to react to changes in federal spending in ways that would stabilize their state budget.

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