MUNICIPAL MARKET INSIGHT

PORTFOLIO ADVISORY GROUP - U.S. FIXED INCOME STRATEGIES GROUP

There's Wealth in Our Approach.™

December 2015

Monthly Overview – No Need to Fear the Fed

We believe that the Federal Reserve will raise rates 0.25% at the December 15-16 Federal Open Market Committee meeting; market forecasts predict a 74% chance, and numerous Fed officials have expressed their support for the move. It would be its first interest rate increase since June 2006, and throughout 2015, markets have been fixated on the timing of the rate hike. Shifting expectations for the Fed's launch date have contributed to market volatility, and one would hope that will diminish somewhat after December 16; however, that may be wishful thinking as attention will now turn to the timing of additional rate hikes. We agree with the Fed's message that this tightening cycle will different—slow and gradual—and, as such, interest rates should remain well contained. So, our message to investors is to not fear the Fed, as rates are not likely to move sharply higher. Additionally, we think that any volatility should be used as an opportunity to selectively add to current portfolios.

In this issue of *Municipal Market Insight*, you'll find:

Our Thoughts on the Need to be Selective: Even though this rally may be getting old, we think it still has some room to run, and we note the selective opportunities for investors.

Perspective on Puerto Rico's "Clawback" Maneuver: The Commonwealth was able to pay all scheduled debt service on the Government Development Bank (GDB) bonds on December 1 as a result of Governor Alejandro Garcia Padilla's executive order to begin clawing back revenues from certain other bonds

An Update on Muni Bond Insurers: Ambac Assurance Corp. and National Public Finance Guarantee (NPFG) reported declines in Puerto Rico exposure.

Additional News Headlines from Puerto Rico: The Detroit bankruptcy judge supports bankruptcy for the Commonwealth, and recent employment data give mixed signals.

News Highlights: They include Atlantic City, New Jersey; various Chicago-related issuers; Connecticut; Massachusetts; New Jersey; and New York City.

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RBC Wealth Management™

U.S. Treasury Rate Forecasts (% as of November 2015)

	2015				2016			
	Q1	Q2	Q3	Q4E	Q1E	Q2E	Q3E	Q4E
FF	0.25	0.25	0.25	0.50	0.75	1.00	1.25	1.50
2-yr	0.56	0.64	0.64	1.05	1.30	1.50	1.70	2.00
5-yr	1.37	1.64	1.37	1.85	2.05	2.15	2.30	2.55
10-yr	1.94	2.35	2.04	2.45	2.60	2.70	2.85	3.05
30-yr	2.54	3.12	2.86	3.20	3.30	3.35	3.45	3.55

Source - RBC Economics

Treasuries vs. Municipals

	5-yr TSY	5-yr AAA Muni	10-yr TSY	10-yr AAA Muni	30-yr TSY	30-yr AAA Muni
Beginning of month (11/1/15)	1.52%	1.17%	2.14%	2.04%	2.92%	3.07%
Mid-month (11/15/15)	1.65%	1.31%	2.27%	2.17%	3.05%	3.15%
End of month (11/30/15)	1.65%	1.26%	2.21%	2.02%	2.97%	2.96%

Source - Bloomberg (Treasury), Thomson Reuters TM3 (Municipals)

Market Investment Strategy & Market Commentary

Be a "Selective" Investor – Performance Remains Strong

Municipal bonds are on pace to be one 2015's best-performing asset classes. According to Barclays' data, munis have posted five consecutive months of positive performance, and munis have returned 2.58% year to date. For comparison, Treasuries are up 1.01%, and corporate bonds have returned 0.10%.

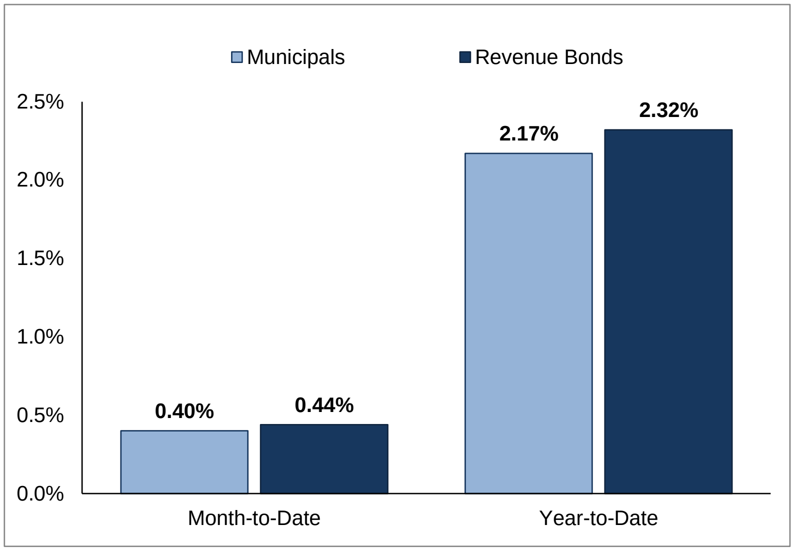
The fuel for this rally has been strong demand from traditional investors and consistent inflows into municipal bond mutual funds. Even foreign investors see the relative value opportunities as evidenced by the November announcement that a Japanese bank was working with a U.S.-based money manager to set up a yen-denominated municipal bond fund.

Valuations Are Stretched; but, Demand Will Outpace Supply

We frequently cite muni/Treasury (m/T) ratios (they are included on page 10) as good indicators as to where the best opportunities are in the muni market. To date, m/T ratios have suggested investors will pick up the most value by extending maturities. But the recent rally in munis has caused these ratios to compress, the 30-year ration sits at just 100%. As result, broadly speaking, values aren't as compelling as they were in early September. But, even so, investors extending out from 5- to 30-year maturities can still increase yield by approximately 1.73%.

Tightening m/T ratios could mean the current rally may be getting a little "long in the tooth," but we think there is still some room to run, at least through year-end due to a growing demand/supply imbalance. Muni new issuance has declined for each of the past three months largely due to the sharp decline in refunding activity. As a result, as 2015 draws to a close, primary market issuance will be lucky to top $400B compared with earlier $430B projections. At the same time, the continued low rate environment has resulted in many outstanding issues being called, which, when combined with scheduled maturities, has created more demand than supply. This dynamic will lend continued support to munis and add to a string of positive performance, in our opinion. But with values stretched, we believe investors need to be selective.

Municipal and Revenue Bond Total Returns



Source - RBC Wealth Management, Barclays; Data through October 2015

In previous issues of *Municipal Market Insight*, we have noted the potential risks from chasing yield in high-yield issues. We believe that a better way to boost yield (and performance) without sacrificing credit quality is to focus on the revenue bond space. The chart above shows how revenue issues have posted better performance numbers than general obligation bonds. Throughout the year, essential-service bonds (water and sewer), certain non-profit hospital systems, airport revenue bonds, and utility bonds have performed well, providing investors with good investment alternatives.

Puerto Rico Invokes Clawback Provision

The Commonwealth paid all scheduled debt service on the Government Development Bank (GDB) bonds on December 1, despite Puerto Rico officials' repeated claims that the Commonwealth may not have sufficient resources. In addition, Governor Garcia Padilla signed an executive order to begin clawing back revenues from certain other bonds, including Puerto Rico Highway and Transportation Authority bonds, Puerto Rico Infrastructure Finance Authority bonds, and Puerto Rico Convention Center District Authority bonds (collectively "clawback bonds") to pay future General Obligation (GO) and GO guarantee debt service. GO bonds have a first priority right to the revenues otherwise pledged to the clawback bonds. This revenue clawback made it possible to cover the GDB's $354M payment that came due on December 1. The Commonwealth guaranteed approximately $267M of the $354M

In prepared remarks before a U.S. Senate Subcommittee on December 1, Governor Garcia Padilla stated,

> *"In light of the rapidly deteriorating revenue situation, in accordance with Article 6, Section 8 of the Constitution of the Commonwealth of Puerto Rico, I ordered the "clawback" of revenues assigned to certain instrumentalities of the Commonwealth for the repayment of their debts. Together these instrumentalities have approximately $7 billion in bonds outstanding. In simple terms, we have begun to default on our debt in an effort to attempt to repay bonds issued with the full faith and credit of the*

Commonwealth and secure sufficient resources to protect the life, health, safety and welfare of the people of Puerto Rico."

Senate Committee Hearing Synopsis

The Republican chairman of the Judicial Committee indicated bankruptcy should be the end of the line, not the front of the line, and that escape from debt is a bad idea because it will not address the fundamental challenges that created this crisis. Other Democratic committee members struck a more-sympathetic tone.

All parties, except Commonwealth officials, felt some form of Federal Oversight was necessary in concert with any proposed bankruptcy authorization. However, the committee appeared much more divided on the bankruptcy authorization idea. Proponents for bankruptcy believed that Chapter 9, while imperfect, is the only way to legally address the pending defaults, while opponents felt Chapter 9 authorization would be changing the rules mid-game and would ensure the Commonwealth's permanent exclusion from the capital markets.

Security Standing Honored—for Now

We are pleased that the Commonwealth adhered to the security hierarchy by clawing back revenues to pay the GO and GO-guaranteed debt instead of just willfully defaulting on its obligations to pursue an ill-advised slash-and-burn agenda.

As such, at this point, we believe the Commonwealth will also pay its January 1 GO debt service payments, but, unfortunately, to the detriment of the clawback bonds. Since the Commonwealth did not disclose the amount to be clawed back, we cannot confidently gauge the impairment to the clawback bonds. In the short run, most of the clawback bonds have cash funded debt service reserves and should be paid from those funds; however, given the magnitude of the Commonwealth's financial crisis, we believe the ultimate prospects for the clawback bonds are grim.

COFINA

We think the COFINA structure will be tested by the Commonwealth and/or GO bondholders; however, the available information, including the entire construct of the COFINA financing vehicle, strongly suggests the COFINA revenues are not subject to the clawback provision.

GO Bondholders Should Not Get Too Comfortable

While the clawback provision materially benefits GO bondholders, we want to reinforce the magnitude of the Commonwealth's crisis, which gets even more burdensome when a viable solution to the island's pension problem is factored in. Therefore, future impairment risk to the GO obligation is still present. We believe that the future prospects for the GO and GO-guaranteed bonds will be influenced by various forces including future Commonwealth treatment of the obligation, and U.S. Congress' decisions on super Chapter 9 bankruptcy, a Federal Oversight board, and economic and fiscal stimulus packages.

Chapter 9 Bankruptcy Authorization

The Republican-controlled Congress has showed minimal interest at this juncture in providing Chapter 9 authorization to the Commonwealth; however, we believe some form of municipal bankruptcy ultimately will be authorized. From our vantage point, the Republicans would like to first place a Federal Oversight Board to resolve the fiscal crisis and then consider bankruptcy as a final alternative; however, in our opinion, the liquidity crisis does not afford such time. The clawback bonds should experience a technical default on January 1, and then legal chaos will ensue because there is presently no legal forum to constructively address both Puerto Rico's and creditors' rights, in our opinion.

We believe Chapter 9 bankruptcy should not be used as a crutch, but that bankruptcy is a necessary tool if conditions warrant. Also, municipal bankruptcy authorization is merely the first step in the process because the municipality must then prove insolvency. Admittedly, Chapter 9 authorization gives the municipality more bargaining power, but it still must prove it is insolvent, and, furthermore, Chapter 9 provides a legal framework, albeit flawed, to cure an untenable situation.

Commonwealth of Puerto Rico Update

Bankruptcy Option – Detroit Bankruptcy Judge Rhodes Weighs In

U.S. Bankruptcy Judge Steven Rhodes said the Commonwealth needs to be placed on life support and allowing it through bankruptcy is the right way to confront the Commonwealth's current crisis. At the same time, Rhodes called for a central control person or board, preferably designated by the federal government to begin proceedings as a substitute to the governor and legislature.

October Employment Report & Economic Activity Index (EAI) Update – Mixed Signals

The United States Bureau of Labor Statistics' household survey showed total employment was up 0.1% since September, marking the fourth consecutive month-to-month employment increase. The Commonwealth's unemployment rate jumped to 12.4% in October from 11.4% in September due to October's 9.3% rise in the number of unemployed. October's unemployment rate was still 1.5% lower than in October 2014.

The Commonwealth's EAI rose 0.2% in October from September and 1% from October 2014. It marked the third straight month the index has gained on a month-to-month basis and second month it rose on a year-over-year basis.

Insurance Commentary

Insurers Continue Facing Headwinds

Bond insurers continued facing headwinds in the third quarter as low interest rates, tight credit spreads, and a drop in primary market issuance limited the amount of bonds that were insured. Assured Guaranty and National Public Finance reported year-over-year declines in third-quarter earnings, while Build America Mutual (BAM) reported a statutory loss.

Assured Guaranty wrote policies on $3.1B of new muni issues, representing 60% of insured par and 56% of the insured issues during the quarter. Build America Mutual reported an 11% increase in gross par outstanding and that its claims-paying resources rose $5.8M to $596.6M. National Public Finance, which has been measured in its re-entry to the market, insured $129M of par in the third quarter through a combination of primary and secondary market underwriting.

With, in our opinion, the Federal Reserve preparing to lift rates, we expect the headwinds faced by the bond insurers to begin to subside, allowing for growth in market share.

Ambac Assurance Corp. and National Public Finance Guarantee (NPFG) – Puerto Rico Exposure Declines

NPFG's exposure to Puerto Rico issuers declined by $155M when the Puerto Rico Highways & Transportation Authority (PRHTA) purchased some of its outstanding debt. After purchasing the debt, PRHTA canceled the insurance policy on November 13. In a similar move, PRHTA purchased $228.5M of its outstanding debt and canceled the Ambac insurance policy covering the debt. The cancelation of the policies reduces potential losses to the insurers.

As of November 30, 2015

Insurer	Moody's	Standard & Poor's	Kroll Ratings
ACA	Not Rated	Not Rated	Not Rated
AMBAC	Not Rated	**R	Not Rated
Assured Guaranty (AGC)	A3 (negative outlook)	AA (stable outlook)	Not Rated
Assured Guaranty Municipal Corp. (AGM)	A2 (stable outlook)	AA (stable outlook)	AA+ (stable outlook)
Berkshire Hathaway (BHAC)	Aa1 (stable outlook)	AA+ (negative outlook)	Not Rated
Build America Mutual (BAM)	Not Rated	AA (stable outlook)	Not Rated
CIFG	Not Rated	Not Rated	Not Rated
FGIC	Not Rated	Not Rated	Not Rated
Municipal Assurance Corporation	Not Rated	AA (stable outlook)	AA+ (stable outlook)
National Public Finance (MBIA)	A3 (negative outlook)	AA- (stable outlook)	AA+ (stable outlook)
Syncora	Not Rated	*R	Not Rated

*R-Regulatory Supervision (NYS Insurance Department), **R-Regulatory Supervision (Wisconsin Insurance Department)

Source - RBC Wealth Management

Municipal Market Headline Events

Atlantic City, New Jersey – Possible Insolvency???

After Governor Chris Christie conditionally vetoed legislation that would have redirected some casino revenue to the cash strapped city, Mayor Don Guardian said the city could run out of cash by the beginning of April 2016. The city was banking on the redirected funds to close a projected $101M deficit this year. Absent a cash infusion, the city will not be able to borrow cash to remain afloat.

Earlier in November, Standard & Poor's kept the city's rating on CreditWatch Negative in advance of the city's emergency manager report and legislation providing the city with a financial assistance package. The rating is likely to remain on credit watch following the governor's conditional veto of some casino revenue assistance for the city.

Chicago Board of Education (CBOE) – Rating Placed on CreditWatch Negative

Standard & Poor's placed the school districts rating on CreditWatch with negative implications, based on its inability to maintain 2016 budget assumptions. The CBOE, facing a liquidity crunch, could see its rating cut multiple notches if it cannot demonstrate adequate liquidity.

Chicago – Illinois Supreme Court Appeal a Longshot

Municipal buyside participants and legal experts are holding little hope of the city succeeding in its pension reform appeal to the Illinois Supreme Court. The city is appealing a lower court ruling issued in July voiding the city's pension reform overhauling its laborers and municipal employees' funds. The city is currently responsible for 50% of the city's $20B of unfunded pension liabilities. A ruling against the city could, absent a fix, drive its current rating further into junk territory absent.

Connecticut – Another State Facing Pension Issues

The Center for Retirement Research at Boston College recently released a report commissioned by Governor Dan Malloy recommending the state should divide the State Employees Retirement System, (SERS) into two separate funds. The plan would divide the system into a pay-as-you-go system for employees hired before 1984 and a separate fund for eligible employees hired after 1984. According to the report, SERS' funding level stood at 42% with a total unfunded accrued liability of $14.9B. The bifurcation of the state's main public pension fund is an attempt by the state to erase it unfunded liability by 2032.

Cook County Illinois – Adopts 2016 Budget with Tax Hikes

Cook County, home of Chicago, approved a $4.5B 2016 budget, which relies on several tax hikes to help the county address its sizable pension needs. The county's finance team cut nearly $200M to eliminate its preliminary gap through operating efficiencies and cuts, and reducing the gap to $20M. In addition, the county added a 1% tax on hotels and motels, which, is expected to generate $15.4M in annual revenue for the next budget and $31M when fully implemented on an annual basis. The county also plans to cut other expenses, reduce its workforce by 1.2%, and increase some other taxes to address its structural deficit.

Florida – Governor Scott Pursuing Tax Cuts

Next month, Governor Rick Scott is expected to release his 2017 spending plan, which seeks to offer business in his state approximately $1B in tax cuts if the Legislature approves his upcoming budget proposal. Scott's plan will seek to eliminate $770M in income taxes on manufacturing and retail businesses, eliminating $77M in taxes on manufacturing, machinery, and equipment, and seeks to cut $339M in taxes on commercial leases.

Illinois – Budget and Pension Strains Could Further Impact Rating

Moody's Investors Service warned that the state's economic strengths and fiscal flexibility could not be enough to shield the state from further credit erosion. In the event the state's financial position continues to deteriorate, the state credit rating could move closer to junk. The state, which is operating without a budget is facing bill payment deferrals, chronic structural gaps, and soaring unfunded pension liabilities. Moody's currently rates the state Baa1, three levels above junk.

Illinois's Comptroller Leslie Geissler Munger said the state, despite its ongoing budget impasse, will make its scheduled $560M December pension payment after warning of cash constraints to make November's payment. The state's coffers rise in December due to increased sales tax receipts from holiday shopping, allowing for the December payment.

Long Island Power Authority (LIPA) – Rating Revision

Fitch and Standard & Poor's revised their outlooks on LIPA to stable from negative following a recent three-year rate hike that is expected to improve the utility's financial outlook in the next three years. The change to stable from negative was timely as the issuer sold $117M of Series 2015B and $149M in Series 2015C electric system general revenue bonds shortly thereafter.

Massachusetts – Rating Outlook Change

Standard & Poor's revised the state's AA+ rating to negative from stable. The state's financial reserves are projected to decline despite a period of economic expansion and positive revenue trends. The negative outlook, which is mainly due to declining reserves, also took into consideration reserve drawdowns in fiscal year's 2013 and 2014 and suspension of transfers by the state to its budget stabilization fund.

Nassau County, N.Y. – Facing Obstacles

Nassau County, operating under the supervision of the state appointed seven-member Nassau Interim Finance Authority (NIFA), voted to reject the county's $2.95B budget proposal because of its reliance on anticipated revenue including video lottery revenue which may not materialize. According to the NIFA, the county's financial plan would continue a structural imbalance between expenditures and revenue through 2019.

New Jersey – Revenue Trending Ahead of Last Year

New Jersey Acting State Treasurer Ford M. Scudder announced that the state collected just over $2.06B in October, leaving it on track to see revenue beat last year. Through October, the state collected $7.1B in revenue for fiscal year 2016, a 2.9% increase from the same period a year ago. In addition, October sales tax collections were 6.1% ahead of last October and up 4.5% fiscal year to date, well ahead of state budget projections of a 2.9% increase.

New York City – On Track to Post a 2016 Surplus

The city announced it was on track to end fiscal 2016 with a $304M surplus. City spending has virtually remained flat since mayor Bill de Blasio's budget passed. The city's overall budget has increased to $79.9B from $78.5B, boosted by new federal grants for Hurricane Sandy and for homeland security.

RBC Wealth Management Retail Trading (10/30/2015 - 11/30/2015)

Top 10 CUSIPs Selling Volume to Retail Customers

CUSIP	Description	Maturity	Coupon	Volume
088518LB9	BEXAR CO-REF	08/15/2051	4.00	7,807
19648AM44	CO HLTH FACS AUTH	06/01/2043	5.63	5,518
755783AN7	REAGAN HOSP DIST-A	02/01/2039	5.13	5,387
88283KBG2	TX TRANSPRTN-C-AGM	08/15/2037	5.00	5,000
73358WZK3	PORT AUTH OF NEW YORK	10/15/2055	5.25	3,783
88283KAY4	TEXAS TRANSPRTN-C-REF	08/15/2037	5.00	3,450
850578TU9	SPRINGFIELD ELEC-REF	03/01/2040	4.00	3,220
73358WZJ6	PORT AUTH OF NEW YORK	10/15/2045	4.00	2,999
64972GCE2	NYC MUN WTR FIN-EE	06/15/2047	5.00	2,939
613347FV0	MONTGOMERY HSG OPP	01/01/2053	4.20	2,514

Top 10 CUSIPs Buying Volume from Retail Customers

CUSIP	Description	Maturity	Coupon	Volume
6461393H6	NJ TURNPIKE-A	01/01/2038	5.00	2,769
246317EB3	DELAWARE RVR & BAY	01/01/2032	4.00	1,519
6461393R4	NJ TURNPIKE-A	01/01/2043	5.00	1,463
167484QZ0	CHICAGO CAB-CITY CLGS	01/01/2034	0.00	1,254
786009AZ3	SACRAMENTO MUN-COS	07/01/2022	4.75	1,128
74514LD20	PR-REF-A	07/01/2035	5.00	1,127
59259Y3P2	MTA-A1-TRANSPRTN A	11/15/2040	5.00	1,117
64972GAZ7	NYC MUNI WTR-BB	06/15/2047	5.00	1,111
54714FAA8	LOVE FIELD ARPT-SW-AI	11/01/2040	5.25	958
646136XT3	NJ ST TRANS-BAB-C	12/15/2028	6.10	893

Source - RBC Wealth Management

RBC Capital Markets Institutional Trading (10/30/2015 - 11/30/2015)

Top 10 CUSIPs Selling Volume to Institutional Customers

CUSIP	Description	Maturity	Coupon	Volume
372546AU5	GEORGE WASHINGTON UN	09/15/2045	4.87	48,111
889184AA5	TOLEDO HOSPITAL	11/15/2045	4.98	29,790
51166FCK3	LAKELAND ENERGY-REF	10/01/2036	5.25	26,002
455141QB0	IN TRN FIN REF-SER-C	12/01/2022	5.50	20,456
646136Y54	NJ TRANSPRTN TRUST-AA	06/15/2045	5.00	19,827
546415T59	LOUISIANA ST-C-REF	08/01/2024	5.00	16,965
010608D61	ALABAMA PUB SCH	12/01/2023	5.00	16,276
646136Y39	NJ TRANSPRTN TRUST-AA	06/15/2041	5.25	15,344
79765RTL3	SAN FRANCISCO WTR-BAB	11/01/2050	6.95	13,666
403755S69	GWINNETT CNTY SD-REF	02/01/2031	5.00	13,452

Top 10 CUSIPs Buying Volume from Institutional Customers

CUSIP	Description	Maturity	Coupon	Volume
646136Y96	NJ TRANSPRTN TRUST-AA	06/15/2038	4.75	34,992
889184AA5	TOLEDO HOSPITAL	11/15/2045	4.98	28,389
51166FCK3	LAKELAND ELECTRIC-REF	10/01/2036	5.25	25,949
455141QB0	IN TRN FIN REF-SER C	12/01/2022	5.50	20,443
646136Y54	NJ TRANSRTN TRUST-AA	06/15/2045	5.00	18,725
546415T59	LOUISIANA ST-C-REF	08/01/2024	5.00	16,922
010608D61	ALABAMA PUB SCH	12/01/2023	5.00	16,275
645918U35	NJ ST ECON DEV-NN	03/01/2030	5.00	15,554
646136Y39	NJ TRANSRTN TRUST-AA	06/15/2041	5.25	15,300
403755S69	GWINNETT CNTY SD-REF	02/01/2031	5.00	13,794

Source - RBC Capital Markets

Bond Buyer Indexes

Weekly	Current 11/24/2015	Previous 11/19/2015	2015 High	Date	2015 Low	Date
Bond Buyer Revenue Bond Index	4.05%	4.04%	4.56%	(5/21)	4.04%	(11/19)
Bond Buyer 20-Bond Index	3.63%	3.65%	3.87%	(6/11)	3.29%	(1/15)
Bond Buyer 11-Bond Index	3.14%	3.16%	3.34%	(9/3)	3.14%	(1/15)

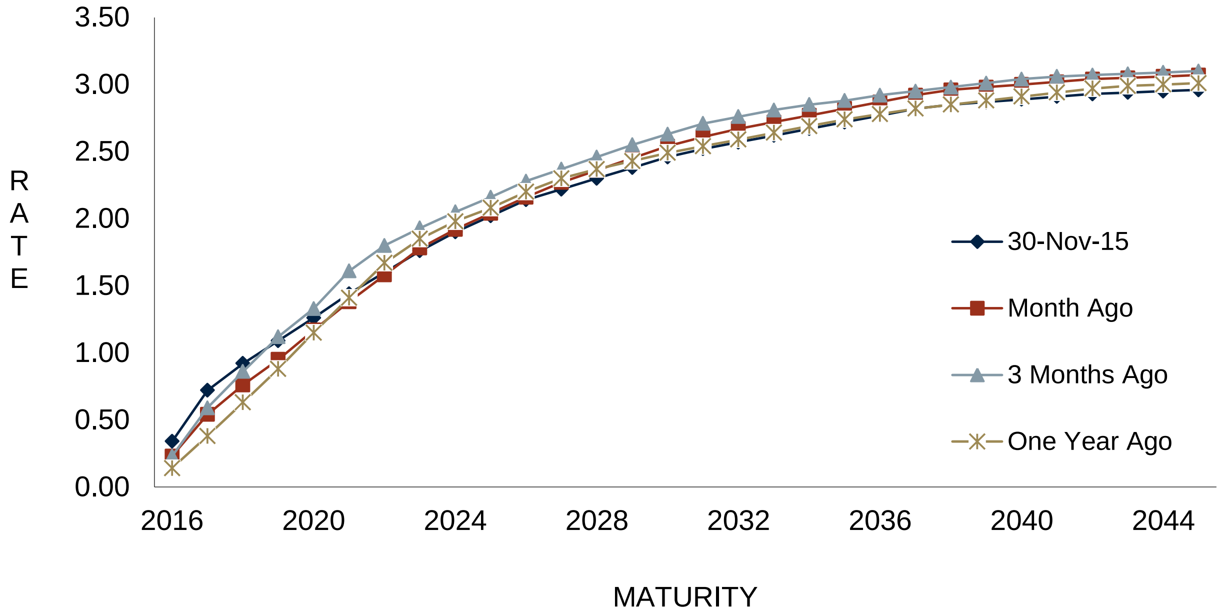
Source - *The Bond Buyer*

Barclays Municipal Index Returns (as of 11/30/15)

	INDEX								
	1 Year (1-2)	5 Year (4-6)	10 Year (8-12)	15 Year (12-17)	Long Bond (22+)	AAA	AA	A	BAA
Month-to-Date Total Return	-0.13%	-0.10%	0.39%	0.65%	0.88%	0.25%	0.31%	0.59%	0.69%
Year-to-Date Total Return	0.63%	2.23%	2.93%	2.89%	3.38%	2.21%	2.50%	2.79%	3.45%

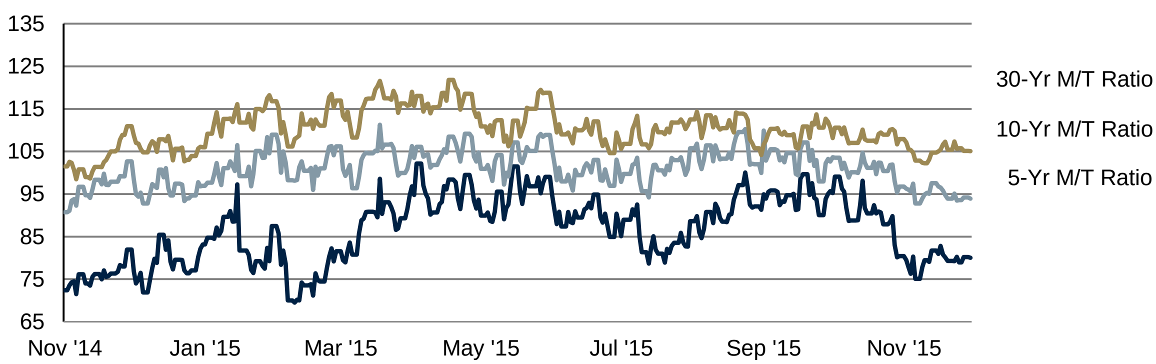
Source - Barclays

Muni Market Data AAA Yield Curve



Source - RBC Wealth Management, Thomson Reuters TM3

Muni/Treasury Ratio Comparison



Source - RBC Wealth Management, Bloomberg