

## Q&A

### 'Picking bonds is like taking basketball shots,' says Mansour



**Paul Mansour**, Director, Municipal Credit at Conning, Inc. in Hartford, Connecticut, spoke about the up-and-down year in the bond market and what kinds of credits he's looking at heading into 2012 with Municipal Market's Brian Chappatta.

#### **Q: What is your outlook for the municipal bond market in 2012?**

**A:** Looking at reduced municipal bond supply again is a key factor from a technical point of view. From a longer-term perspective we've got the baby boomer phenomenon, where the first baby boomers turn 65 this year. So that investor class, as they get older, prefers municipal bonds. We do see a growing economy which is also helping the asset class, in terms of stabilizing state revenue. And we see that these municipalities made tough choices and people are starting to see that there isn't going to be this wave of defaults. These are the things that are making me pretty bullish for the next 12 months. What I follow is the inflows to funds. In the first six months of the year they were negative to flat, but we've been on quite a roll since the summer. Municipal bonds are largely held by individual investors, and the best way to gauge that is these fund flows. When you start to see that, it's a very positive sign. For quality deals, retail is buying half to 70 percent of the deal before institutions even get a chance to participate.

#### **Q: Can't that be a problem, considering that retail investors are the most susceptible to negative headlines?**

**A:** It's clearly a concern for the sector that we have a high percentage of buyers who are subject to headline risk. At the same time, they seem to be shrugging these things off. Harrisburg has been a problem for many years, and Jefferson County has also been out there for many years. What I'm worried about is a credit we didn't expect, say a City of Chicago or New

York that all of a sudden has this huge problem that's a surprise. That would be a troubling situation. Even if California has more problems, and I think they will in December because they have these automatic budget cuts that may be triggered, the market will also largely shrug that off because California has been a problem for so long. Even when there have been problems lately, you haven't seen a big tail-off in prices. These opportunities have not been created because there's such a strong demand for the asset class that it overwhelms everything right now.

#### **Q: What are you looking at in terms of revenue bonds?**

**A:** We very much like public power bonds. In California, we have some great public power credits to pick from. Whether it's Sacramento Municipal Utility, which is doing exceptionally well, or Los Angeles Department of Water & Power, both credits are doing well, even though they're being asked to contribute more to the local government. They're still very strong franchises in low-cost power. So some of these credits have inherent advantages. Whether it's an exclusive service area, rate-making authority, or lower-cost hydro power, they give them a sustainable long-term advantage. They're very durable-type credits.

#### **Q: What is it specifically about the essential service sector you like?**

**A:** We like the essential service sector because they're more capital-intensive credits, as opposed to GO credits, which have human resource costs as a much

higher percentage of their expenses. Right now capital is on the cheaper side, and human costs are on the higher side. We like essential service credits where you have either a competitive advantage in terms of lower rates, or where you have a legal advantage in that you have a defined service area with the ability to set rates and no realistic opportunity for competition. One of the problems with the Jefferson County deal is that they never had mandatory connections in that service area. You didn't have to hook up to sewer. Most deals, they have local ordinances where you have to be hooked up to water and sewer.

#### **Q: What's your ideal buy?**

**A:** A perfect deal for us would be a 15-year maturity, water and sewer, high to low AA rating, in a weaker state. That would be the type of credit we're looking for. Picking bonds is like taking basketball shots. You need a few layups, where you find those easy ones, but we also have to take a few three-point shots. And then there are those in the middle, which are state GOs, maybe some smaller issues or some healthcare credits. You're trying to have a little bit of everything, but the core position of what we own has got to be in that mid-A to AA rating with a lot of liquidity where you can get ongoing disclosure, and if you want to sell it you can. I can only raise my hand so many times to force people to sell things, so we have to pick bonds that are liquid in a reasonable rating category. Customers give us guidelines that we have to live by in terms of rating quality. So we pretty much have to stick to the core of what we buy.