INVESTMENT SUMMARY

We rate Puerto Rico bonds a Sell. We believe that Puerto Rico and certain related issuers face financial challenges due to the ongoing restructuring of a significant portion of these issuers' debt, weak economy and persistent budget shortfalls. Payments on most of these bonds have been suspended during the restructuring, although bond insurers have continued payments on some insured issues. We expect most of Puerto Rico's challenges to continue, which poses risks for bond holders.

BOND OVERVIEW

Puerto Rico and related issuers are restructuring their debt. Puerto Rico's debt restructuring, officially named the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), was enacted in 2016. Interest and principal payments have been suspended on these bonds, although bond insurers have continued payments on some insured issues. The restructuring is very large and complex due to the many stakeholders involved, including bond holders, bond insurers, pension beneficiaries, government officials and tax payers. As a result, progress has been slow. We expect this pace to continue, with negotiations playing out over several years, facing legal challenges along the way. While the ultimate outcome and timing is uncertain, most of these bonds could eventually be exchanged for newly-issued bonds with a reduced par value and different terms.

Economic indicators are weak. Puerto Rico's economy, measured by GDP growth, has effectively been in recession since 2005 (Organization for Economic Co-operation and Development, World Bank). A significant driver of this trend is outmigration – the population is estimated to have declined to about 3.2 million from the peak of about 3.8 million in the early 2000s (U.S. Census Bureau). Even with a smaller labor force, unemployment remains elevated near 9% (U.S. Bureau of Labor Statistics). We expect these trends to continue to put pressure on the tax base and revenues available to support debt.

Budget shortfalls have been persistent. Puerto Rico's government has operated with its expenses generally exceeding revenues since the early 2000s (U.S. Government Accountability Office).

Analyst: Brian Therien, CFA

This opinion does not apply to Puerto Rico Housing Finance Authority or bonds that have been prerefunded or escrowed to maturity.
### Required Research Disclosures

<table>
<thead>
<tr>
<th>Appropriate for Income</th>
<th>Appropriate for Aggressive Income</th>
<th>Sell</th>
<th>FYI</th>
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<tr>
<td>We consider bonds to be an appropriate holding for investors seeking income within a well-diversified portfolio. Our time horizon is 3-5 years.</td>
<td>We consider bonds appropriate only as a small Aggressive Income portion within a well-diversified portfolio. Bonds within this category are riskier, with a higher possibility of loss due to default, than bonds classified as Income. Our time horizon is 3-5 years.</td>
<td>We recommend investors sell these bonds. We believe these bonds are no longer an appropriate fixed-income holding because, in our opinion, they offer an unattractive risk/reward scenario at current prices. Our time horizon is 3-5 years.</td>
<td>For informational purposes only; factual, no opinion.</td>
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Initiated Coverage (SELL) 7/25/12

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