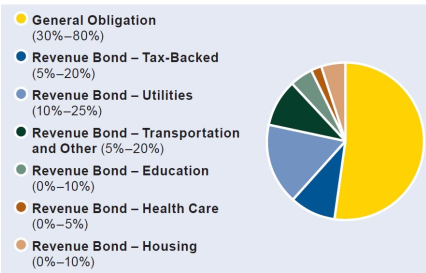
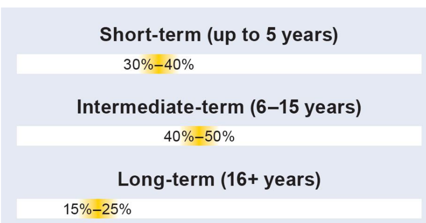
General Obligation Outlook

MUNI - BOND SECTOR REPORT

U.S. Rec. Municipal Sector Weightings:



U.S. Recommended Bond Ladder:



Sector Participants:

- States
- Local governments (i.e., cities and counties)
- Special Purpose Districts (i.e., school districts and hospital districts)

For more information:

If you have any questions, please contact a local Edward Jones financial advisor, or write to: Edward Jones,12555 Manchester Road, St. Louis, MO 63131.

Outlook: Stable

Our outlook for the general obligation (GO) sector is stable. GO bonds may be backed by a state or local government's full faith and credit, but are typically backed at least by some combination of taxes and other available funds. While the legal meaning of "general obligation" varies by state, a GO pledge is typically backed by a broad willingness to highly prioritize principal and interest payments. We view GOs as having stronger security than bonds backed by annual appropriations, which typically require approval in the budget.

There have been pressures across the sector related to pensions, growing health care costs and aging infrastructure. However, we expect these challenges to remain manageable for most issuers.

Most state and local governments benefit from the ability to raise revenues when needed due to their taxing authority and their role in providing essential services while facing limited competition.

Also, government fund balances have improved broadly as governments focused on building reserves during the recent years of economic growth. We generally expect state and local governments to maintain relatively strong credit quality despite the challenges they are facing.

Overall, we generally expect state and local municipalities with diverse and growing economies, stable or rising home values, and greater financial flexibility, provided in part by the ability to raise revenue and control spending, to remain financially strong. Although pockets of stress exist, with those rated in the "BBB" range, below investment grade (BB+/Ba1 or lower) or nonrated likely being the most vulnerable.

Sector Strengths:

- Ability to raise revenues when needed due to taxing authority and role in providing essential services while facing limited competition
- Government fund balances and reserves having grown during recent years of economic growth
- High prioritization of general obligation bond payments

Sector Challenges:

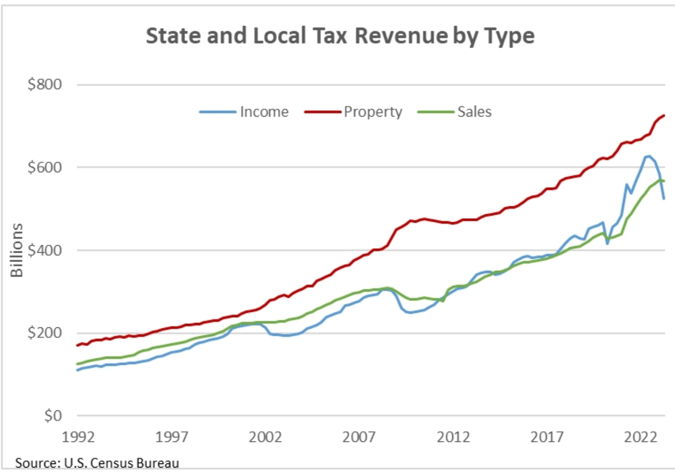
- Rising pension and health care costs
- Aging infrastructure
- Tax revenues being sensitive to economic cycles, especially income taxes

Analyst: Brian Therien, CFA

Please see important disclosures and analyst certification on page 3 of the report.

Sector Outlook Rationale

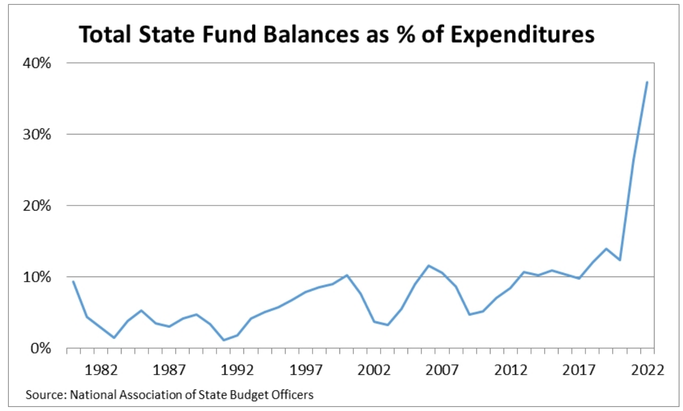
States generally have a dependency on sales and income taxes, while local municipalities tend to rely more on property and sales taxes. As shown in the chart below, state and local tax revenues have grown over time, with temporary declines during economic recessions.



Many GO issuers benefit from strong financial flexibility, with states generally having more financial flexibility than cities and counties. Financial flexibility means multiple options and resources are available to help balance budgets, which may include the ability to increase revenues, delay projects and cut funding for services that are less essential or that have other funding sources. Relatively low debt also enhances financial flexibility by allowing more money to be available for expenses other than annual principal and interest payments.

While we believe governments generally benefit from relatively strong financial flexibility, the willingness to use certain alternatives could be low or politically unpopular. For example the willingness to raise taxes to stabilize or grow revenue likely remains low, especially in cities or states where tax rates are already high relative to peers. More municipalities are choosing to increase service fees as an alternative.

Many municipalities have made the tough choices to balance budgets, which involves maintaining expenses at or below revenues. As shown below, many states have grown total fund balances, which help provide financial flexibility and to prepare for economic downturns.



There has been pressure on governments to increase spending on services and programs such as education, infrastructure improvements and public safety that are important for economic growth. However, a recent National League of Cities survey indicated that the recent economic downturn is expected to drive tax revenues lower, especially for municipalities that are more reliant on sales taxes. While lower revenues and expense pressures create challenges, we expect most state and local governments to continue making difficult budget decisions necessary to maintain financial stability.

A major expense for many municipalities has been pension and retirement health care benefits. According to a recent report by Moody's Investor Service, state pensions are underfunded by about $1.7 trillion and retirement health care benefits by about $450 billion. This means that total obligations exceed investments set aside to support them. Investment returns have also generally been lower than expected in recent years, which has contributed to growing these obligations. We believe additional changes will be needed to help prevent pension and retirement health care benefit obligations from becoming overly burdensome.

Solutions to pension underfunding will vary by state and locality and remain unclear from a broad perspective. However, many governments have implemented pension and health care benefit reforms and/or increased funding in recent years. We believe most governments have tools available to help deal with the problem, and pension funding remains manageable for most. According to a recent report by Moody's, fixed costs represent about 4.8% of revenue for states, 7.6% for counties and 11.3% for cities, which we believe provides a large cushion to provide services and fund pensions in most cases.

Municipalities that make the full required annual pension contribution and implement reforms where necessary will likely be in a stronger financial position in the long run. Pockets of distress across the nation may still exist with defaults, if any, occurring mostly to nonrated bonds or bonds rated below the "A" category.

Outlook Definitions

Positive - The factors impacting the credit quality of a given sector are likely to be or are supportive of an improved credit environment in the near term.
Stable - The factors impacting the credit quality of a given sector are likely to be neutral to the credit environment in the near term.
Negative - The factors impacting the credit quality of a given sector are likely to or have produced a weak or uncertain credit environment in the near term.

Analyst Certification

I certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers; and no part of my compensation was, is, or will be directly or indirectly related to the specific recommendations or views contained in the research report.
Brian Therien, CFA

Required Research Disclosures

Other Disclosures

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Past performance is no guarantee of future results.

If you sell this security prior to maturity, you may receive more, less, or the same dollar amount you originally invested because the security's market value may fluctuate over time due to various market factors (e.g., interest rates).

Before investing in bonds, you should understand the risks involved, including interest rate risk, credit risk and market risk. Bond investments are subject to interest rate risk such that when interest rates rise, the prices of bonds can decrease, and the investor can lose principal value if the investment is sold prior to maturity. The value of bonds fluctuates, and you may lose some or all of your principal. Municipal bonds, while free from federal income tax, may be subject to state and local taxes and the alternative minimum tax (AMT).

You must evaluate whether a bond ladder and the securities held within it are consistent with your investment objectives, risk tolerance and financial circumstances. Including callable bonds may increase the interest rate risk of a bond ladder. Bonds may be called prior to maturity, which could result in lower yields with new investments.

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