

California Debt Investment and Advisory Commission Municipal Debt Essentials: Accessing the Market

Market Efficiency: Improving an Agency's Cost Effectiveness

October 23, 2013 Oakland, CA

Fidelity Capital Markets (FCM) Facts

- Customer-focused institutional trading firm under the Fidelity umbrella
- FCM is a full service underwriter with \$2 billion capital base*
- Conduit to 13.7 million individual accounts and with \$1.7 trillion in assets**
- Active in competitive municipal sales since 1987
- Active as co-manager in negotiated sales since 2007

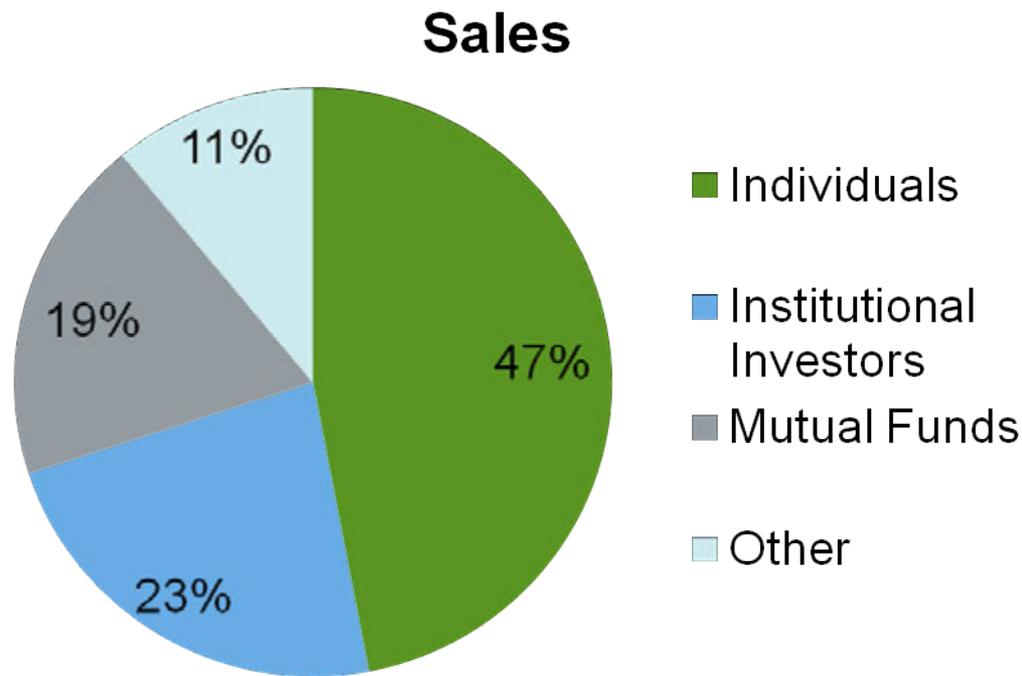
- Debra Saunders
 - Over 20 years as credit analyst at Ambac Assurance
 - Masters in Public Administration
 - Series 7, 63
 - Opened West Region Municipal Finance office for Fidelity Capital Markets in 2010

* Source: March, 2013 FOCUS Report

** Source: Fidelity unaudited data as of September 30, 2013

Who is buying your bonds?*

Retail dominance of the municipal market is unique compared to other asset classes

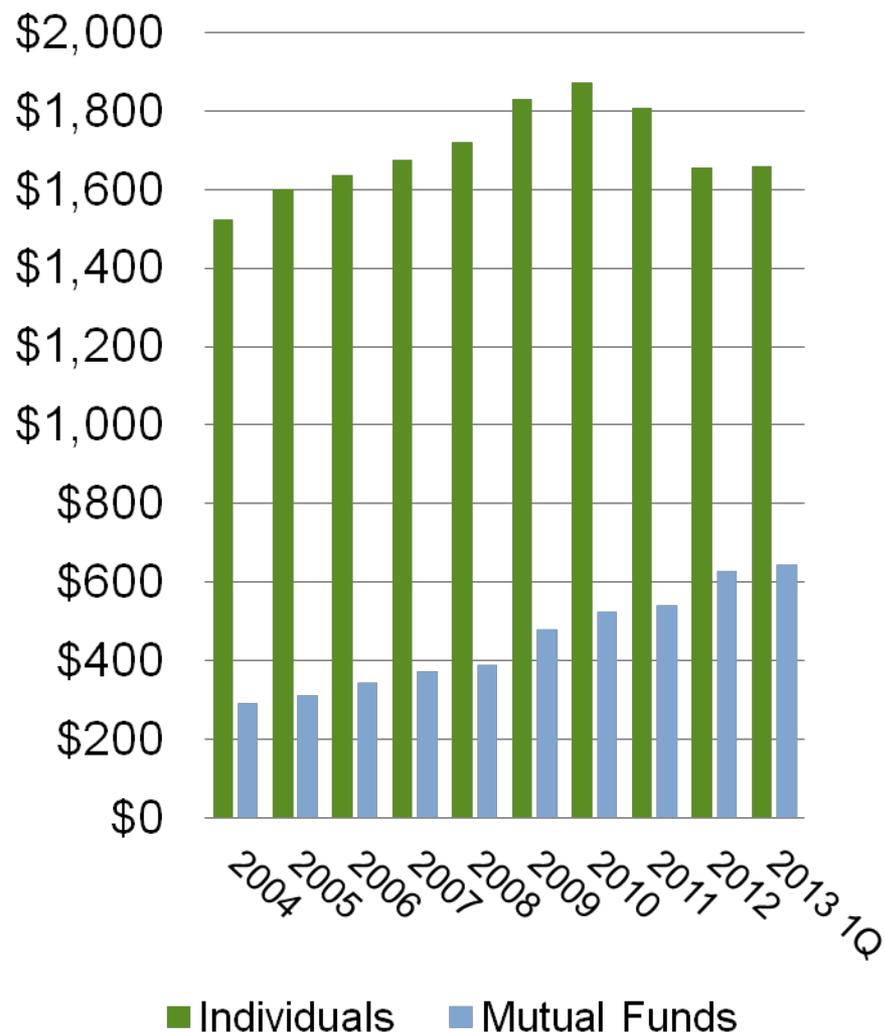


Holders of Municipal Bonds

- Household holdings is down from over 50% in 2004
- Mutual funds have increased holdings, from 10% in 2004

The environment:

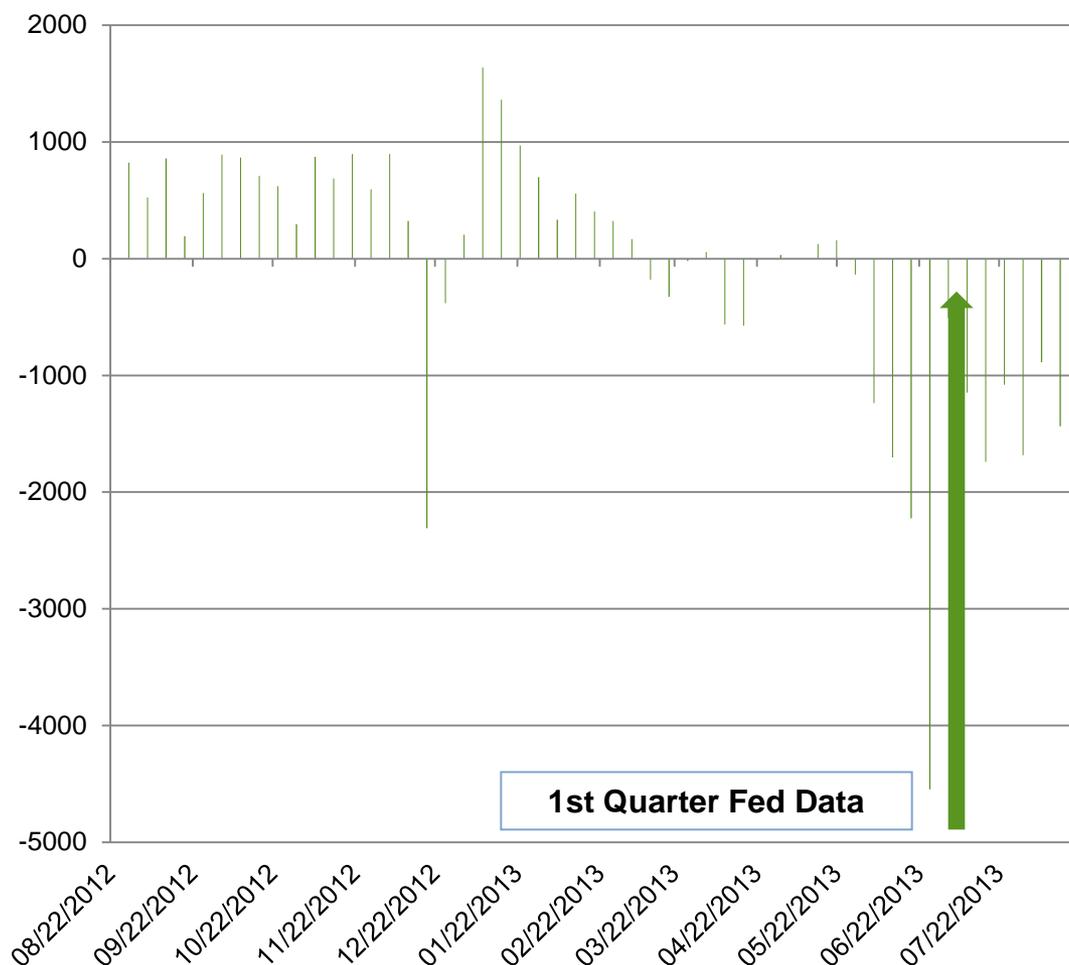
- Fiscal crisis, credit fears and bond insurance
- Low interest rates, expectation of rising rates
- Rising rates depress mutual fund NAV's



Mutual Fund Flows

- Low interest rates, some retail investors waiting for rates to rise
- Rising rates drive declines in NAV which triggers further selling.
- In the past 12 months, municipal bond flow of funds have turned from mostly inflows to mostly outflows.

Mutual Fund Flows US\$ mill



Advantages to individual investors

Purchasing bonds during the original offering provides advantages to investors:

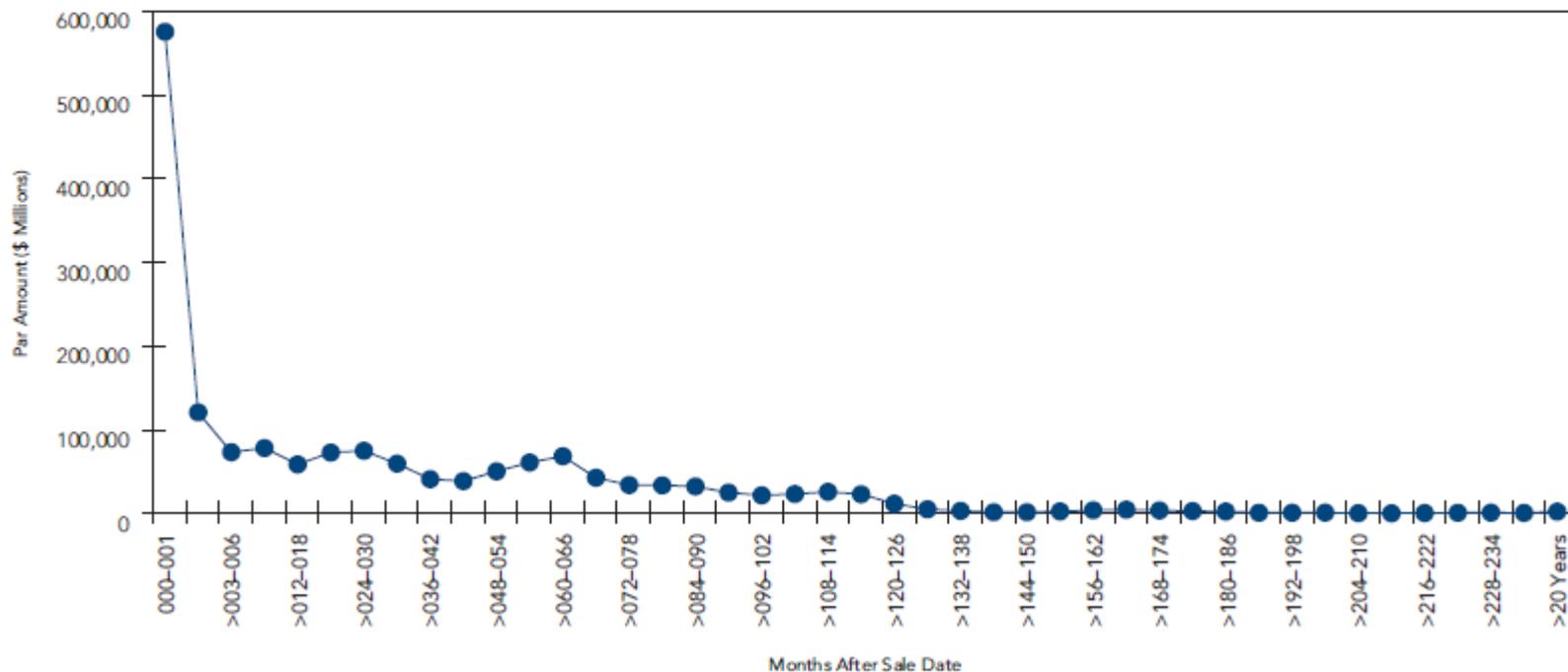
- Often, they get to place orders before institutional investors, such as mutual funds or insurance companies and may get higher priority.
- They get the same price and yield as larger institutional investors who buy bonds or notes with the same maturity date after the early order period.
- They do not pay a brokerage fee or commission.

Plus:

- Disclosure is up to date
- Call dates are furthest out
- Ratings are fresh

When individuals buy bonds

Par Amount Traded by Months After Sale Date¹, 2012



An Issuer's perspective: primary vs. secondary

Potential benefits to issuers of reaching retail directly in the new issue market

- Accommodating retail order periods puts bonds in hands of local constituents at same price as institutions
- Buy and hold may reduce secondary market activity
- Reaching all investor classes improves market efficiency and lowers borrowing costs; lowers exposure to changes in one investor class
- Retail order periods take some supply off the table, drives demand for remaining bonds
- Transparency and equality of pricing in primary market is good for the market as a whole

There are different types of retail investors

Type of Investors	Buying preferences	Structure
Individual retail	Internet, phones, \$5-25K	Par, 10 years
Separately Managed Accounts	Large firms: From lead managers Medium-small: captive	All coupons, 10+ years
High Net Worth	Broker-assisted, \$100K-\$5M	Par, slight premiums, 10-15 years
Family Office	Broker assisted	Par/preservation of capital

What does retail look for?

- Reasonable certainty of order execution
- Interest rate “thresholds”
- Cash flows that are intended to match expected needs
 - College, Retirement, Income
 - Bond ladders
- Do it yourselfers
 - Tools for research
 - Liquidity
- Coupon and redemption structures
 - Serial bonds
 - Call protection
 - Par-risk bonds

Where Did All the Retail Go?

Why is such large segment of ultimate owners absent during bond issuance?

Historically, order periods were 3 weeks long, broker dealers were paid 4% to find buyers and had plenty of time to do so

- Model has shifted due to technology and competition
 - Lower takedowns, retail brokers seek higher return assets
 - Wholesale-oriented platform/move bonds quickly

- Inefficiencies in the market seem to benefit institutional buyers
 - Fast pace/internal resources
 - Bonds may be “flipped” to retailers

How to Reach Retail Buyers

- Marketing process that is accommodative and can reach all investors
 - Net Road Show
 - Retail Road Show
 - Investor websites
- Retail order periods
 - Negotiated sales only
 - Prior to institutional sales
 - Extended order periods: multiple days, open over weekend
 - Time of day is important
 - Balance needs of retail and institutions

Retail Order Periods*

- The ROP for state bond and note sales typically occurs during the two days before the official bond or note pricing.
- Through the end of the ROP, investors can submit orders through their broker. Bonds and notes cannot be purchased directly from the State.
- Brokers submit investors' orders for bonds or notes in specific amounts and maturity dates based on approximate interest rates.
- Once the bond or note sale is completed, usually the day after the ROP, interest rates are finalized.
- Retail investors are notified of the status of their order and the final pricing. (Note: The ability to fill individual orders depends on the amount of bonds or notes available and the amount of orders. While there is no guarantee, individual orders usually are filled.)
- Investors who order bonds or notes during the ROP have the right to change, or cancel, their order until the order has been confirmed after final pricing.

*www.buycaliforniabonds.com/bcb/rop.asp

Who can participate*

- “Retail investors” are defined to include individuals as well as bank trust departments, investment advisors and money managers acting on behalf of individuals.
- Individual investors purchasing bonds or notes to hold as an investment may purchase during the ROP. Orders from California residents are given priority over residents from other states.
- Individuals may place orders directly with a broker, or they may have a bank trust department or investment advisor place the order on their behalf.
- Generally, orders may not exceed \$1 million. Larger orders are subject to prior approval by the State, its financial advisor or the senior managing underwriter.

*www.buycaliforniabonds.com/bcb/rop.asp

Analyzing MSRB Secondary Market Trading (1)*

MSRB
Municipal Securities
Rulemaking Board

EMMA[®] - Electronic Municipal Market Access
The Official Source for Municipal Disclosures and Market Data

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Security Details

NEW YORK STATE HOUSING FINANCE AGENCY STATE PERSONAL INCOME TAX REVENUE BONDS (ECONOMIC DEVELOPMENT AND HOUSING) 2009 SERIES A (NY)
NEW YORK ST HSG FIN AGY ST PERSONAL INCOME TAX REV ECONOMIC DEV & HSG-SER A (NY)
CUSIP: 649870LB6 *

Dated Date: 06/27/2009
Maturity Date: 03/15/2024
Interest Rate: 4 %
Principal Amount At Issuance: \$2,845,000
Initial Offering Price: 98.254

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Official Statement | Continuing Disclosure | **Trade Activity** | Ratings/AAA

View transaction price and yield information for trades in this security since January 21, 2005.

Trade Activity
Displaying 101 - 146 of 146 trades.

Free

Trade Date/Time	Settlement Date	Price (%)	Yield (%)	Trade Amt. (\$)	Trade Submission Type		
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	5,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		20,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		355,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	100,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	50,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		50,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		25,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	20,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		150,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	50,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	100,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		100,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	200,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	50,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	25,000	Customer bought	W	L

[http://emma.msrb.org/SecurityView/SecurityDetailsTrades.aspx?cusip=649870LB6\(02/13/2012 10:00:19 AM\)](http://emma.msrb.org/SecurityView/SecurityDetailsTrades.aspx?cusip=649870LB6(02/13/2012 10:00:19 AM))

Municipal Securities Rulemaking Board-EMMA

06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	30,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	150,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		50,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		565,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		355,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		50,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		50,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		200,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		100,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		250,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		690,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640		50,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640		50,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640		15,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		20,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		250,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640		25,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	200,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		50,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		100,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	100,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		100,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		20,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	50,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		100,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		25,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		15,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	100,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	97.7640		200,000	Inter-dealer Trade	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	100,000	Customer bought	W	L
06/13/2009 - 01:30 PM	06/07/2009	98.2640	4.18	25,000	Customer bought	W	L

Screen shots are for illustrative purposes only.

Analyzing Secondary Market Trading (2)

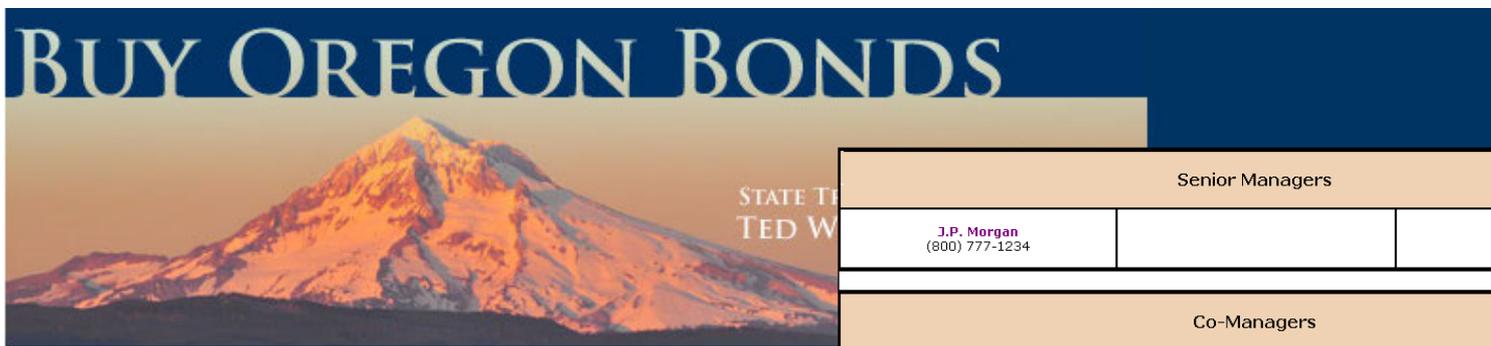
08/13/2009 : 01:17 PM	08/27/2009	99.0390		20,000	Inter-dealer Trade	W
08/13/2009 : 12:55 PM	08/27/2009	99.0390		25,000	Inter-dealer Trade	W
08/13/2009 : 12:55 PM	08/27/2009	100.0390	3.995	25,000	Customer bought	W
08/13/2009 : 11:14 AM	08/27/2009	99.5390		150,000	Inter-dealer Trade	W
08/13/2009 : 11:14 AM	08/27/2009	99.6390	4.015	150,000	Customer bought	W
08/13/2009 : 11:14 AM	08/27/2009	99.5390		150,000	Inter-dealer Trade	W
08/13/2009 : 09:50 AM	08/27/2009	99.0390		10,000	Inter-dealer Trade	W
08/13/2009 : 09:50 AM	08/27/2009	100.7890	3.9	10,000	Customer bought	W
08/13/2009 : 09:45 AM	08/27/2009	99.9270	4.007	25,000	Customer bought	W
08/13/2009 : 09:10 AM	08/27/2009	99.25	4.069	50,000	Customer bought	W L
08/12/2009 : 04:35 PM	08/27/2009	99	4.092	20,000	Customer bought	W
08/12/2009 : 04:34 PM	08/27/2009	98.2640	4.16	50,000	Customer bought	W
08/12/2009 : 04:08 PM	08/27/2009	100	4	25,000	Customer bought	W
08/12/2009 : 04:00 PM	08/27/2009	100.2690	3.963	10,000	Customer bought	W
08/12/2009 : 03:57 PM	08/27/2009	99.7890	4.019	30,000	Customer bought	W
08/12/2009 : 03:57 PM	08/27/2009	99.0390		30,000	Inter-dealer Trade	W
08/12/2009 : 03:18 PM	08/27/2009	98.45		250,000	Inter-dealer Trade	W B
08/12/2009 : 03:15 PM	08/27/2009	98.3750	0	250,000	Customer sold	W
08/12/2009 : 02:48 PM	08/27/2009	98.2640		20,000	Inter-dealer Trade	W L
08/12/2009 : 02:15 PM	08/27/2009	98.2640	4.16	150,000	Customer bought	W
08/12/2009 : 02:10 PM	08/27/2009	98.2640		150,000	Inter-dealer Trade	W
08/12/2009 : 01:31 PM	08/27/2009	98.2640	4.16	50,000	Customer bought	W
08/12/2009 : 01:31 PM	08/27/2009	98.2640	4.16	5,000	Customer bought	W

10/08/2009 : 11:30 AM	10/14/2009	103.96	3.5	25,000	Customer bought	
10/07/2009 : 10:10 AM	10/13/2009	102.1060		25,000	Inter-dealer Trade	
10/07/2009 : 10:10 AM	10/13/2009	103.8090	3.546	25,000	Customer bought	
09/08/2009 : 11:28 AM	09/15/2009	100	4	20,000	Customer bought	
09/02/2009 : 04:05 PM	09/08/2009	97.7680	4.207	25,000	Customer bought	
09/02/2009 : 03:49 PM	09/01/2009	99.9970	4	50,000	Customer bought	
09/02/2009 : 03:11 PM	09/01/2009	98.8720		50,000	Inter-dealer Trade	
09/02/2009 : 03:11 PM	09/01/2009	98.9970		50,000	Inter-dealer Trade	
09/05/2009 : 10:35 AM	09/02/2009	98.9110	4.1	5,000	Customer bought	W
09/05/2009 : 10:35 AM	09/02/2009	98.9110	4.1	5,000	Customer bought	W
09/05/2009 : 10:35 AM	09/02/2009	98.9110	4.1	100,000	Customer bought	W
09/05/2009 : 10:35 AM	09/02/2009	98.9110	4.1	5,000	Customer bought	W
09/05/2009 : 10:35 AM	09/02/2009	98.9110	4.1	5,000	Customer bought	W
09/05/2009 : 10:35 AM	09/02/2009	98.9110	4.1	10,000	Customer bought	W
09/05/2009 : 11:17 AM	09/02/2009	98		30,000	Inter-dealer Trade	W
09/05/2009 : 11:17 AM	09/02/2009	98.10	4.082	30,000	Customer bought	W
09/01/2009 : 03:08 PM	09/27/2009	100.5970	3.924	100,000	Customer bought	W
09/02/2009 : 01:16 PM	09/27/2009	100.1010	3.987	50,000	Customer bought	W
09/02/2009 : 10:05 AM	09/27/2009	98.3720	4.057	30,000	Customer bought	W
09/02/2009 : 09:35 AM	09/27/2009	98.9920	4.001	65,000	Customer bought	W
09/02/2009 : 09:24 AM	09/27/2009	98.3720	4.057	10,000	Customer bought	W
09/19/2009 : 02:44 PM	09/27/2009	98.1390		20,000	Inter-dealer Trade	W
09/19/2009 : 02:44 PM	09/27/2009	100	4	20,000	Customer bought	W
09/18/2009 : 03:12 PM	09/27/2009	100	4	50,000	Customer bought	W
09/18/2009 : 02:07 PM	09/27/2009	98.8890	4.01	50,000	Customer bought	W

Screen shots are for illustrative purposes only.

Fair treatment of individual buyers of municipal bonds -- regulatory attention

- Dodd Frank requires GAO to review aspects of the municipal securities market, including trading and price discovery
- GAO found that institutional investors generally trade at more favorable prices than individual investors.
- SEC is investigating pre-trade price information
- MSRB is committed to increasing pricing transparency for retail investors, but lacks enforcement powers. GAO is also required to determine how federal regulators enforce MSRB rules
- Municipal market is large, relatively illiquid, heterogeneous which creates challenges to secondary market pricing transparency



Brokerage Firms

Please contact your financial advisor for more information about buying bonds in the State. You will need to have a brokerage account to purchase the bonds. If you do not, you may contact one of the following participating brokerage firms. Each firm has its own requirements for opening an account. The State does not guarantee that any one of these firms has bonds for the investor to purchase.

Senior Managers		
J.P. Morgan (800) 777-1234		
Co-Managers		
BofA Merrill Lynch (800) 637-7455	Citi (800) 547-1526	Edward Jones (888) 335-6637
Morgan Stanley Co. Incorporated (877) 937-6739		
Sales Group		
Charles Schwab & Company (866) 855-9102	DA Davidson (503) 525-3600	Fidelity Capital Market Services (800) 544-5372
Keybanc Capital Markets (888) 547-2968	Loop Capital Markets	McAdam Wright & Regan, Inc. (800) 754-2841
McDonald Investments	Piper Jaffray (800) 874-0946	Raymond James & Associates, Inc.

- Links go to:
- New issue webpage
 - Company's issuer-dedicated website
 - Company's municipal bond page
 - Company homepage
 - Phone number of a rep

*hypothetical name

Screen shots are for illustrative purposes only.

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The municipal market is volatile and can be significantly affected by adverse tax, legislative or political changes and the financial condition of the issuers of municipal securities. Interest rate increases can cause the price of a debt security to decrease. A portion of the dividends you receive may be subject to federal, state, or local income tax or may be subject to the federal alternative minimum tax.

Although bonds generally present less short-term risk and volatility than stocks, bonds do contain interest rate risk (as interest rate rise, bond prices usually fall and vice versa) and the risk of default, or the risk that an issuer will be unable to make income or principal payments. Additionally, bonds and short-term investments entail greater inflation risk, or the risk that the return of an investment will not keep up with increases in the prices of goods and services, than stocks.

Interest income generated by municipal bonds and certain securities issued by U.S. territories, possessions, agencies, and instrumentalities is generally exempt from state income tax but is generally subject to federal income and alternative minimum taxes and may be subject to state alternative minimum taxes. Short- and long-term capital gains and gains characterized as market discount recognized when bonds are sold or mature are generally taxable at both the state and federal level.

Short- and long-term losses recognized when bonds are sold or mature may generally offset capital gains and/or ordinary income at both the state and federal level The municipal market is volatile and can be significantly affected by adverse tax, legislative or political changes and the financial condition of the issuers of municipal securities. Interest rate increases can cause the price of a debt security to decrease. A portion of the dividends you receive may be subject to federal, state, or local income tax or may be subject to the federal alternative minimum tax.