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PRESIDENT'S LETTER

MUNICIPAL MARKET UPDATE

Recently, a Kentucky State Appeals Court ruling found that it is unconstitutional for Kentucky to tax municipal bonds issued in other states without applying the same tax to those issued in-state.

Currently, the U.S. Supreme Court is deciding whether to review the above decision (Kentucky vs. Davis). Kentucky asked the Supreme Court last November to review the appeals court decision after the state's high court declined to review.

The municipal market is waiting to see if the Supreme Court will take up the case.

Several dozen states currently do not tax interest income from bonds issued in-state; in effect, their issues are "double exempt" and typically offer lower yields than the general market.

If the Supreme Court does not take up the Kentucky case or if it does review the case and affirms the Kentucky appellate court decision, it is only a matter of time before the "double exemption" feature will be challenged by taxpayers in other states.

Portfolios with a heavy concentration of lower yielding, "double exempt" in-state issues may be vulnerable to market value loss if the Kentucky ruling stands and is affirmed by courts in other jurisdictions. States with high maximum state income taxes include: Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Georgia, Hawaii, Idaho, Iowa, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Missouri, Montana, Nebraska, New Jersey, New York, North Carolina, Ohio, Oregon, South Carolina, Utah, Vermont, Virginia, Wisconsin.

Most of the above states impose an income tax on income earned on out of state municipal bond issues; some of the above states (Utah, as an example) have reciprocal programs under which it exempts taxes on bonds issued by states that exempt its issues.

We do not advise indiscriminate selling of bond issues from portfolios at this point in time.

We continue to recommend portfolio diversity; geographic diversity has always been an important component in our actively managed client portfolios.

State only funds and separately managed portfolios that are heavily concentrated with issues from the states listed above are vulnerable in our view.

A 60% - 75% maximum geographic exposure for high income tax states is a suggested target range and is consistent with Bernardi's recommended strategy for our portfolio managed clients.

Please call us directly if you have any questions or concerns,
or visit us at www.bernardisecurities.com.

Sincerely,

Ronald P. Bernardi
President and CEO
Bernardi Securities, Inc.

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