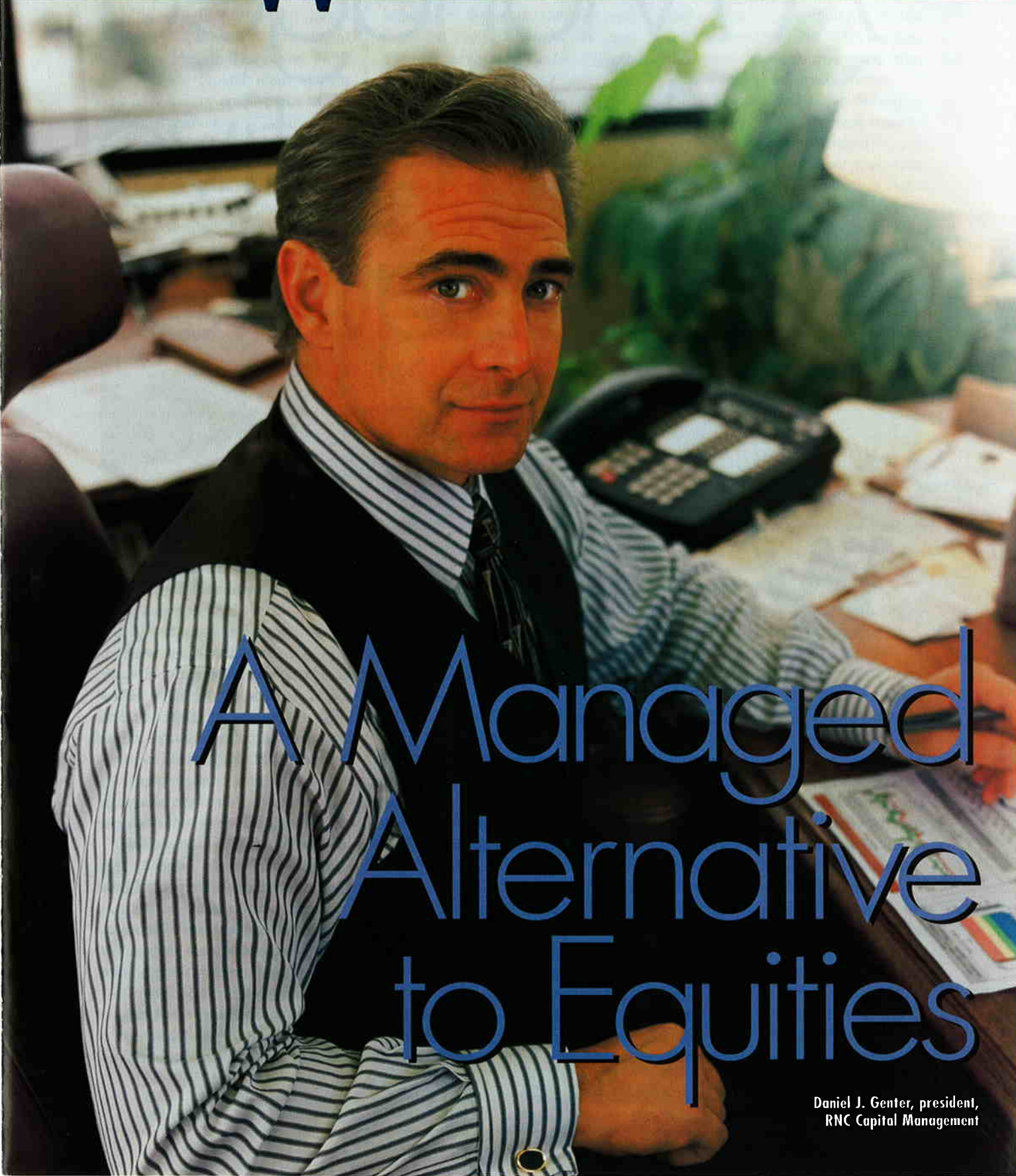


ON WALL STREET

SEPTEMBER 2001

HELPING BROKERS BUILD A MORE SUCCESSFUL BUSINESS

A man with dark hair, wearing a striped shirt and a dark vest, is sitting at a desk in an office. He is looking towards the camera with a slight smile. The desk is cluttered with papers, a telephone, and other office supplies. In the background, there are office chairs and a large green plant.

A Managed Alternative to Equities

Daniel J. Genter, president,
RNC Capital Management

A Managed Alternative to Equities

To supplement client equity portfolios, separately managed municipal bond accounts can provide value. *By Evan Cooper*

While the separately managed account business has exploded from just \$75 billion in assets under management to \$275 billion in the past six years, according to a recent report from Cerulli Associates, one segment of this booming business has gone largely unnoticed

. That corner of the managed account world deals in municipal bonds, and for many investors — whether or not they live in states where tax-exempt returns are especially desirable — separately managed municipal bond accounts may be worth considering

Using their institutional knowledge and market clout to select and trade municipal bonds, the managers of these separately managed muni accounts currently are producing returns that outpace their more popular equity cousins, often with greater safety and consistency. And with investors as a group seeking the security of fixed income assets, those at the higher end of the wealth spectrum are finding separately managed muni accounts particularly suited to their needs.

“These accounts start to make sense for those with about \$1 million to invest,” says Clark Stamper, president of Stamper Capital & Investments Inc., of Santa Cruz, Calif. Stamper manages the \$294 million Evergreen High Income Municipal Bond Fund (VMPAX), which carries a four-star Morningstar rating. He also manages about \$20 million in separately managed accounts, where he says the average account is worth about \$1.7 million and holds 45 positions, with an average of \$40,000 in each position.

For those whose total portfolios are large enough, placing a portion in a separately managed municipal bond account as opposed to an advisor-selected portfolio of municipal bonds has several advantages. The most obvious is cost. The municipal bond market, with its vast number of issues, maturities and ratings, is far less liquid or transparent than the equities market, which translates into higher transaction costs. As institutional buyers and sellers, muni managers have an edge. Stamper, for example, says the spreads on his purchases and sales are

usually 25 basis points, not the 300 bps typically charged at retail.

Another advantage is market breadth. Harris May, who heads Strategic Partners Investment Advisors, Inc., in Tarrytown, N.Y., says that the typical retail advisor sees only a very small piece of the municipal market.

"If you're a broker with a large firm, your first charge is to sell what your firm has in inventory," he says, noting that independents and advisors also are funneled to their broker-dealer's trading desk. "But as a manager, it's a hub and spokes concept. I can look at inventory at Morgan Stanley, Merrill Lynch, UBS PaineWebber and regional

to look at the municipal bonds in their current portfolio, the most common thing we see are tremendous imbalances between maturities and the yield curve," he said. "If there had been any strategy at all in selecting the bonds, it was based on laddering. But the rungs of the ladder usually break down because whoever recommended buying the bonds ignored call features or extraordinary redemption features. We take all that into account — as well as other factors such as the Alternative Minimum Tax — and explain what might happen to a portfolio under various market conditions."

Because his traders are in the market full-time, Genter says they can

sports figures and in the entertainment business."

The gatekeepers to these wealthy individuals — particularly in the entertainment business — are accountants and business managers, who often were trained as accountants.

"When you deal with gatekeepers — whether a CPA, business manager or a family office manager — you have to understand what motivates them. These are accountants who have graduated to more responsibility, and they are not by nature or history revenue generators. They are revenue counters. They are not attuned to methods of increasing return because they are extraordinarily risk averse, and are paid to account



'The wealthy want to make sure the money is going to be there and won't go away.'

firms, so when an inquiry comes in I can shop impartially for bonds all over the country."

May, who is working with smaller regional broker-dealers to develop separately managed account programs, says his typical account size is \$750,000 to \$1 million. He says separately managed muni accounts work well for advisors whose primary emphasis is equities, but who want to be able to offer superior service in the fixed income area as well.

Daniel J. Genter, president of RNC Capital Management in Los Angeles, says the biggest advantage of using a managed approach to municipal bond ownership is that professionals can add considerable value in a market that is not only much less liquid and more opaque than equities, but also less widely understood.

"When clients come in and ask us

find value for clients in out-of-state bonds the investor or his regular advisor might not otherwise consider.

Many of Genter's clients in the separately managed muni accounts are in the entertainment business, and he says his product's conservative, risk-reducing features help convince wary business managers that these accounts are the right choice for their clients.

"The higher net worth person has a different, more sophisticated mentality about investing," he says. "They want to make sure the money is going to be there and won't go away. Return of money, not necessarily outsize returns, becomes their most important goal. They want to know they'll have enough money to generate the income they need to live the life style they want regardless of what happens. This is particularly true of many of our clients, who are

for risk and avoid it. They are very tax sensitive."

But with separately managed municipal accounts, Genter says, these characteristics can be an advantage.

"If you discuss active municipal bond management, you're talking about something that few others are talking about. You can explain strategies that enhance returns and lower risk, and show tax strategies the gatekeepers never heard of. And in bonds, it's all quantifiable."

While the managed muni segment is currently small, Genter sees enormous growth potential.

"There is vast wealth in the 55-and-over segment, a lot of which came from liquidity events," he says, noting that those who cashed in aren't likely to put that money back into equities. "We've never seen this much capital." **OWS**

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CAPITAL
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Company*

Daniel J. Genter

President, C.E.O. & C.I.O.

11601 Wilshire Boulevard, 25th Floor

Los Angeles, CA 90025

310 477-6543 800 877-7624

kcertain@rnccapital.com

www.rnccapital.com