BY WARREN BOROSON
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Maybe it's a good time to lighten up on any New Jersey municipal bonds or municipal bond funds you own. Or dump them altogether.

One smart money manager, Scott Noyes, CFA, CFP, president of Noyes Capital Management in New Vernon, points out that some of the state's municipalities are in financial trouble, which may lead to their ratings getting downgraded by credit-rating companies. A downgrading usually means the bonds will lose some value. And so will owners of those bonds.

Noyes makes a strong case.

"Due to the decline in property values and loss of income-tax revenues," he has written, "municipal bond ratings for New Jersey towns are being reduced at a faster rate than any other state in the nation, according to Bloomberg news."

In early December, Moody's downgraded some debt issued by Woodbridge Township, the state's sixth-largest municipality, from Aa3 to A1. The rating for a new Irvington bond was lowered from Baa3 to Ba1, a notch below investment grade.

"Cities across the state are facing looming budget shortfalls, service cuts, and staff layoffs," he reports. "Pension liabilities are a growing problem. The good times are over for New Jersey municipalities."

He expects further downgradings after municipalities report their financial budgets for 2010 – typically in the first quarter.

Noyes himself has sold off many of his clients' N.J. municipal bonds and N.J. bond funds and replaced them with national bond funds, individual bonds of safer states, or taxable securities. Two of his favorite funds: American Fund Tax Exempt Bond fund in an F-2 share class (TEAFX) and the Baird Intermediate Municipal Bond Fund (BMBIX).

"I prefer to spread out my bond risk across the country," he has written, "rather than have all of the exposure in one state." (I myself prefer Vanguard municipal bond funds -- I own the intermediate-term fund.)

Now, if you own national muni bonds, you may have to pay New Jersey taxes on the interest. But as Noyes points out, "given the low level of interest rates, the value of the N.J. bond-interest exemption is lower than in periods of higher rates." In any case, he believes that protecting your principal from loss outweighs paying taxes on out-of-state bonds.

He's not giving up on New Jersey tax-exempts.

"Once this risk of downgrades has been better priced into the market," he notes, "I would consider moving back into N.J. bonds and bond funds."

Still, he believes, "municipal bond credit downgrades are one of the biggest investor risks for 2010. This same logic applies to all the other fiscally impaired states, including New York, Illinois, and California. Until municipal governments are able to find solutions to their budget problems, their credit ratings and bond values will be suspect."

Noyes Capital Management is an independent, fee-only money management firm based in New Vernon, NJ.

Question: I have $25,000 to invest in the stock market. What would you recommend?

Answer: Here's a possible portfolio for you – assuming you have adequate life insurance, health insurance, home/renters insurance, etc., along with an emergency fund:

1. Vanguard Dividend Growth, large blend, minimum $3,000, 800-662-6273
2. Vanguard PRIMECAP, large growth, $3,000, 800-662-6273
3. T. Rowe Price Equity Income, large value, $2,500, 800-638-5660
4. T. Rowe Price MidCap Value, $2,500, 800-638-5660
5. Royce Special Equity, small value, $2,000, 800-221-4268
6. Scout International (foreign), $1,000, 800-996-2862

You are invited to submit questions to WGBoroson@gmail.com