# Intermediate Municipal Quarterly Commentary

Fourth Quarter 2017

## Macro Overview

Equity markets rode yet another strong earnings season and tax reform anticipation higher during the quarter, capping off an already solid year. Unemployment continued to decline, and labor market slack diminished further, but a lack of underlying inflation and subdued wage growth kept intermediate and longer-term yields in check. For the quarter, the US Treasury curve saw significant flattening with front-end rates rising as much as 40 basis points (driven by Fed policy) while the long bond was lower in yield by 13 basis points (lack of inflation). Jerome Powell was nominated to be the next Federal Reserve Chair, with the change largely interpreted as a continuation of dovish leaning leadership at the central bank. Powell, who became a FOMC member in 2012, has never dissented on a vote since he took office.

- The ECB modestly tightened monetary policy by reducing asset purchases but remains accommodative overall. UST yields, even at current levels, remain attractive relative to other sovereign debt.
- The FOMC continues to forecast 3 hikes in ’18, with low inflation, which the committee still views as transitory, rising near their 2% target.
- Balance sheet reduction will be slow and deliberate and in the near-term will not put significant pressure on intermediate and longer yields.
- Looking ahead we see two key questions for 2018. Can tax reform help perpetuate the already mature bull market in equities, and will the Fed be able to continue down its forecasted path of deliberate rate normalization in the face of modest price pressures?

## Market Dynamics

The fourth quarter of 2017 will forever be remembered by the immense supply that came to market during the month of December. Issuers rushed to price a record of approximately $63 billion in new deals prior to sweeping tax reform passed at year-end. The original House proposal sought to eliminate both the ability for issuers to advance refund outstanding bonds and to issue new Private Activity Bonds (PABs), while the less restrictive Senate version sought to eliminate just the advance refunding of bonds. The final bill as it relates to the municipal market did align more with the Senate’s version, keeping PABs alive. As amazing as this rush to market was, what was more remarkable was how well the new issuance was absorbed. Knowing that supply could be drastically cut in ’18, investors and dealer desks eagerly purchased the new deals with several sizable transactions showing oversubscriptions of 15x to 20x during the order period.

### Composite Characteristics

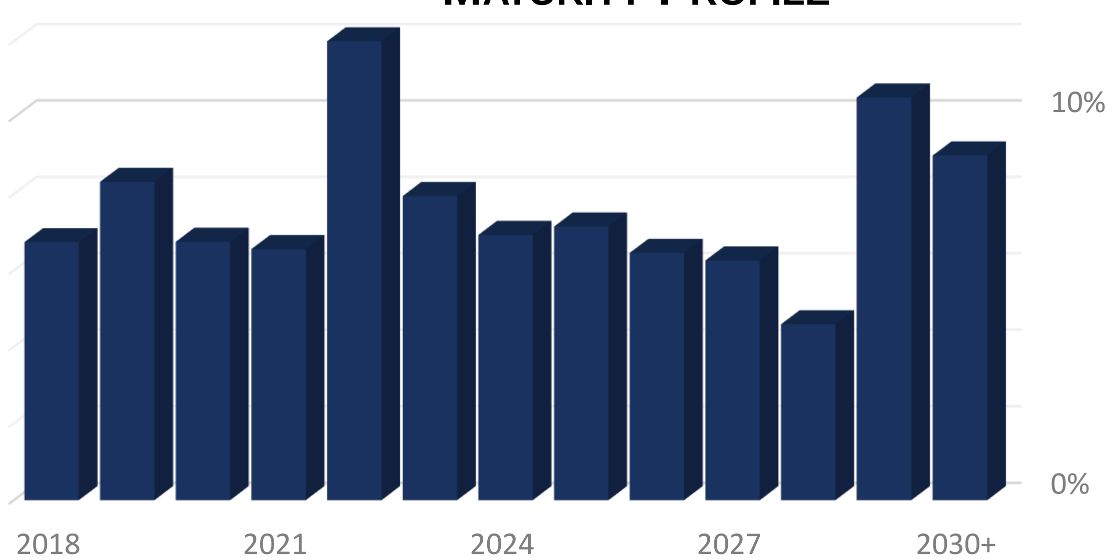
**Duration: 4.41 yrs**

**Yield-to-Worst: 1.96%**

**Yield-to-Maturity: 2.17%**

**Maturity: 6.50 yrs**

### Maturity Profile



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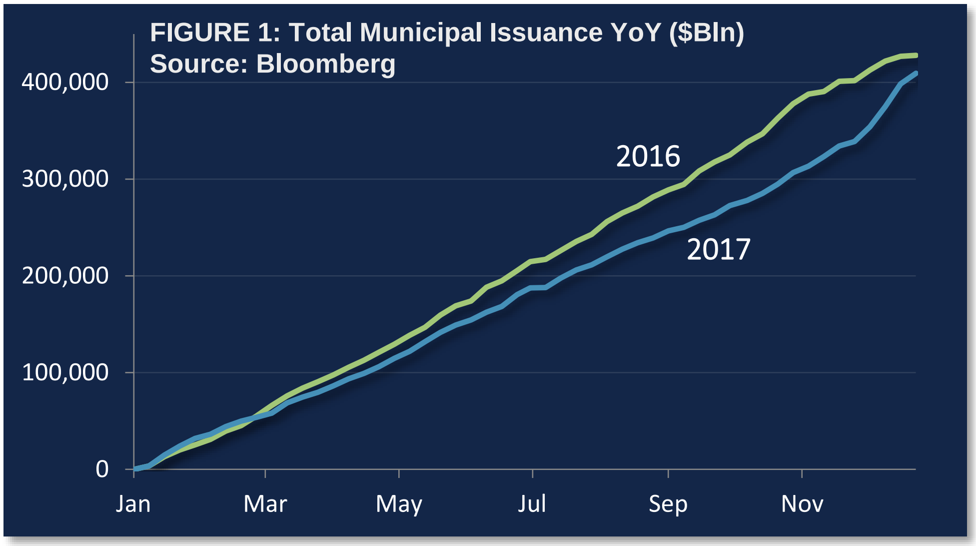
## Performance Notes

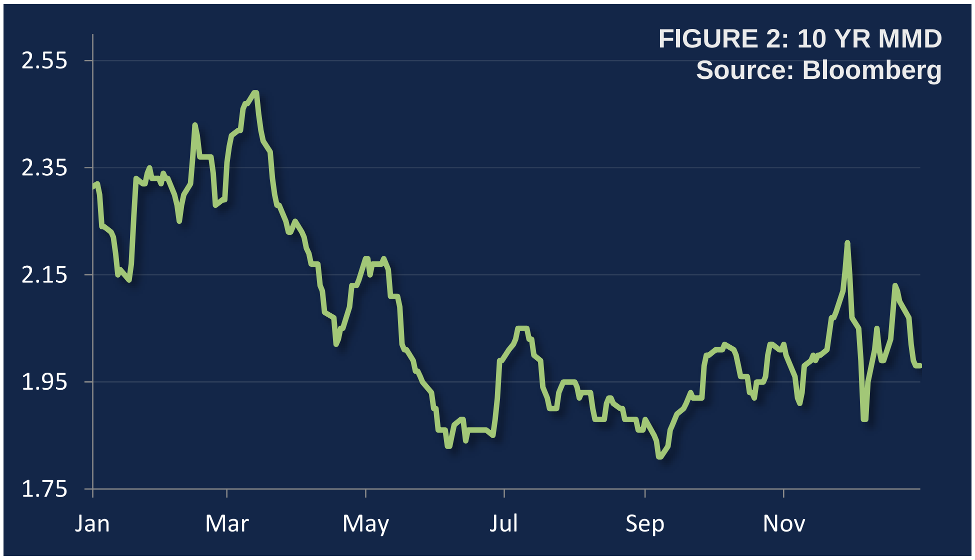
Strategy performance was in-line to slightly below benchmarks over the quarter. The municipal curve continued to flatten with shorter maturities underperforming intermediate and longer dated bonds. Our lower exposure to bonds 15 years and longer proved additive during November's weakness but served as a mild detractor during the rally into year-end. For the quarter, the front-end of the municipal curve was higher by nearly 60 basis points, the middle of the curve was relatively unchanged, while the long-end was lower in yield by almost 30 basis points. Looking ahead, we expect supply to be meaningfully lower for '18, but it will be especially light to start the year as an estimated $40 billion of new deals was pulled into December, front running tax reform. This supply and demand dynamic should prove favorable, and we would expect municipals to perform well into early '18.




"The impact of recently passed tax reform on the municipal market will be pronounced but not as extreme as it could have been. Supply will be markedly lower in 2018 after the rush to market in December…

coupled with the elimination of advance refunding bonds going forward. We expect 2018 supply to be down

…approximately 30% vs. 2017, and our access to a large dealer network will remain vital for sourcing attractively priced bonds.

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