Intermediate Maturity Muni

Commentary – Second Quarter 2019

Macro Overview

The U.S. economy proved resilient in the face of slowing global growth during Q1, however, Q2 was a different story as more mixed economic data began to emerge. Employment remained respectable during the quarter, but leading indicators like ISM slowed on trade war uncertainty. Inflation continued its descent as Core PCE (the Fed's preferred inflation indicator) dropped to 1.6% after beginning the year at 1.95%. The drop in inflation expectations and a dovish FOMC were the primary catalysts for lower rates during the period. Yields on the front-end dropped as much as 50bps, while the intermediate and longer portions of the curve were lower by 40bps and 30bps, respectively. The rapid decline in rates over the quarter signaled market expectations for future rate cuts. It now appears that the Fed may succumb to the pressure, though perhaps not to the degree the market would prefer.

- The Fed removed "Patient" from its most recent statement, and the FOMC now seems primed to cut rates at an upcoming meeting. Current market probabilities for a cut in July '19 are at nearly 100%.
- FOMC remains constructive on the US job market and overall growth but acknowledged that business fixed investment has moderated. Still sees GDP growth in '19 at approximately 2.0%.
- Trade and geopolitical tensions will likely drive intermediate and longer-dated bond yields heading into Q3. Fed uncertainty seems to be less of a factor for the time being.

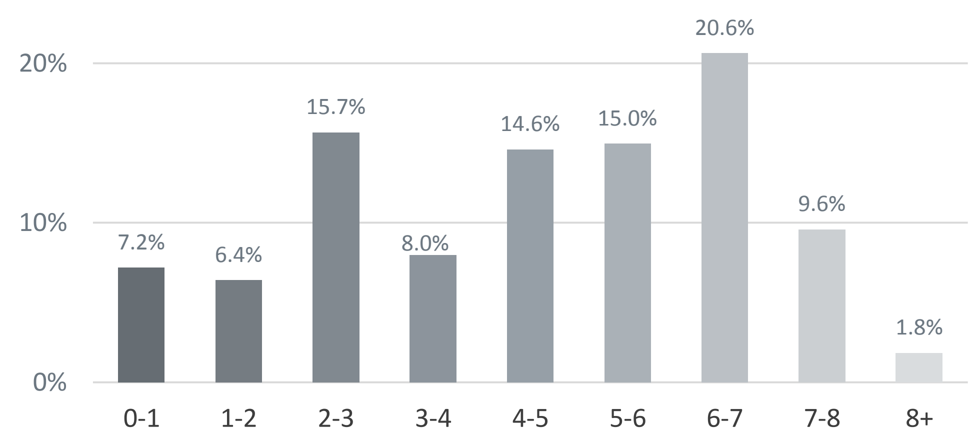
Market Dynamics

Nothing seemed to discourage the impressive fund flows into munis during the first half of the year. In the final week of the quarter, Lipper reported inflows of $1.7bn, marking the 25th consecutive week of net additions. Year-to-date inflows are now over $43bn, a record start to any year since data collection began in the early 1990s. Total issuance was down during the quarter, albeit modestly, but demand as noted before, remains the driver of lower municipal yields. Even as absolute yields have plummeted, muni-to-treasury ratios have cheapened somewhat since their lows of May and look relatively attractive at current levels. Looking forward, we expect demand to slow modestly over the near-term on lower yields, but the likely lack of primary market issuance during the summer months should provide munis with another strong technical backdrop heading into the fall.

Composite Characteristics

Duration: 4.54 yrs
Yield-to-Worst: 1.71 %
Yield-to-Maturity: 1.99 %
Maturity: 6.98 yrs

Duration Profile



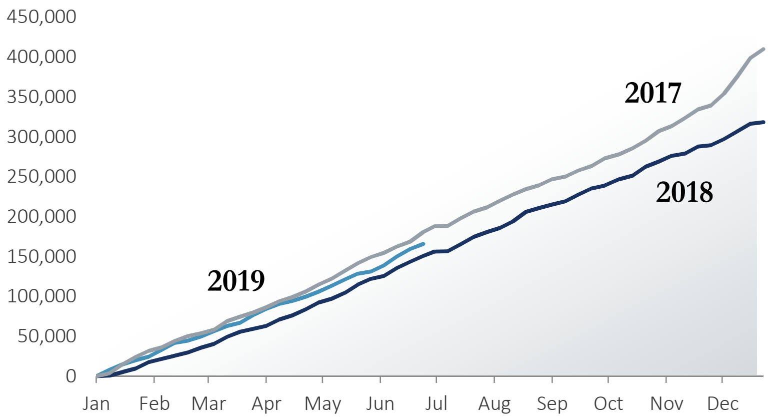
INTERMEDIATE MATURITY MUNI

COMMENTARY – SECOND QUARTER 2019

PERFORMANCE NOTES

Municipals continued to perform well throughout the second quarter with strategy performance in-line with the benchmark as longer duration bonds generally posted higher total returns. Our decision to extend portfolios earlier in the year and then focus new purchases in the 11-15 year portion of the curve has proven beneficial and has helped capture some of the higher returns for maturities past 10 years. Our intermediate municipal strategies posted total returns of nearly 2% for the quarter, boosting year-to-date performance above 4.0%. We also continue to find incremental yield and return potential by moving down the coupon stack with some of our newer purchases and have seen spreads between 5% coupon bonds and lower coupon bonds (i.e. 4% and 3%) compress since the beginning of the year.

TOTAL MUNICIPAL ISSUANCE YOY ($BLN)
SOURCE: BLOOMBERG

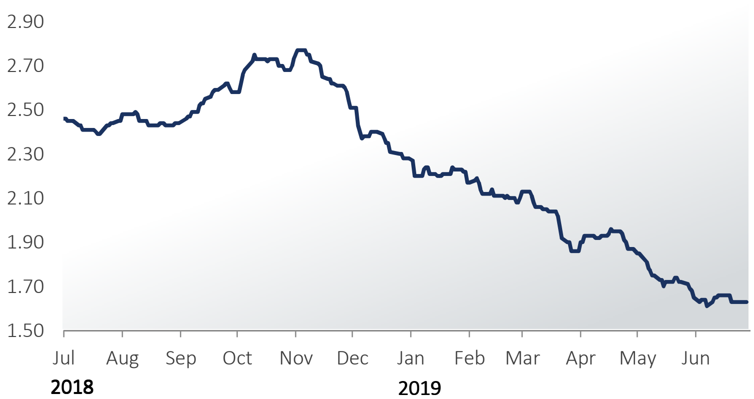


"Even though we believe the pace of inflows will taper somewhat,

market technicals remain strong

as summer redemptions ($40bn alone in July) will be chasing a sluggish primary market."

10 YR MMD YIELD (%)
SOURCE: BLOOMBERG



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