Intermediate Maturity Muni

Commentary – Second Quarter 2020

Macro Overview

The U.S. economy has begun to slowly reopen from a prolonged shutdown, and it appears the 'depression' scenario may have been avoided thanks in large part to aggressive economic stimulus. The Federal Reserve cut its benchmark rate to Zero and committed to unlimited asset purchases while Congress delivered a multi-trillion dollar fiscal package to support individuals and businesses. Bulls will argue the stimulus worked, pointing to US equities having their strongest quarter ever after the drastic Q1 declines. However, the stimulus comes at a very high cost, leaving the country with a record high 'Debt to GDP' of 121%. Additionally, CV-19 has not been fully contained, and recent spikes are causing concern that shutdown scenarios and stay at home mandates will return.

- Despite a rebound in equity markets, economic, labor market, and earnings recoveries will likely take much longer.
- Front-end UST yields tied to Fed Funds will be anchored near Zero with the Fed signaling no interest rate increases in 2021 and most likely not in 2022 either.
- Low intermediate to longer-term UST yields likely in place with low inflation, the need for an economic recovery, and a strong global bid for high quality liquid assets.
- Q1 GDP was revised down to -5% and some estimates are -35% for Q2. We expect a rebound in Q3 and Q4 but still anticipate negative GDP of approximately -6% for full year 2020.

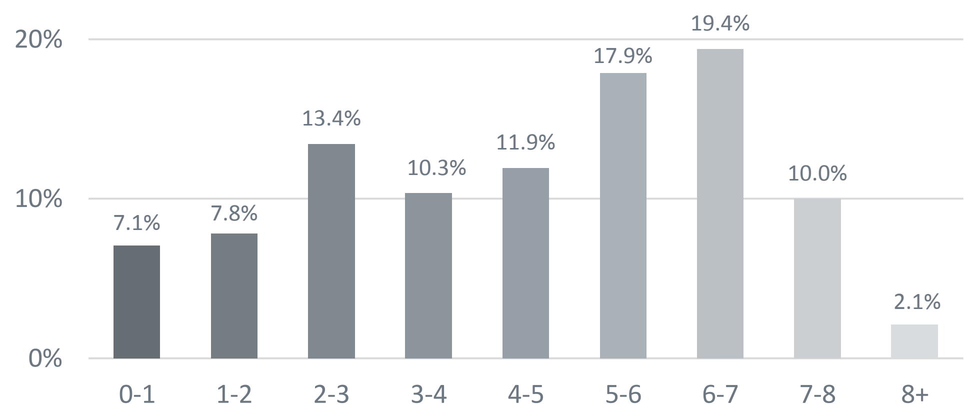
Market Dynamics

Municipal yields reached multi-year highs in mid-March 2020, quickly retreated in April and May, and were relatively range bound during June. While absolute yields remain low, Muni/UST ratios remain attractive and well above historical averages. The Fed will keep overnight rates near Zero for an extended period, and we believe Muni yields will remain subdued as well. However, on a tax-equivalent basis, Munis still offer attractive incremental income relative to similarly rated fixed income products, and this value proposition drove positive fund flows over the past eight weeks. With the Q1 market strain behind us, price discovery and market liquidity are much improved. The focus now turns to credit as many Muni issuers face a myriad of fiscal challenges, and those require diligent surveillance on the part of investors.

Composite Characteristics

Duration: 4.55 yrs
Yield-to-Worst: 1.11 %
Yield-to-Maturity: 1.51 %
Maturity: 7.11 yrs

Duration Profile



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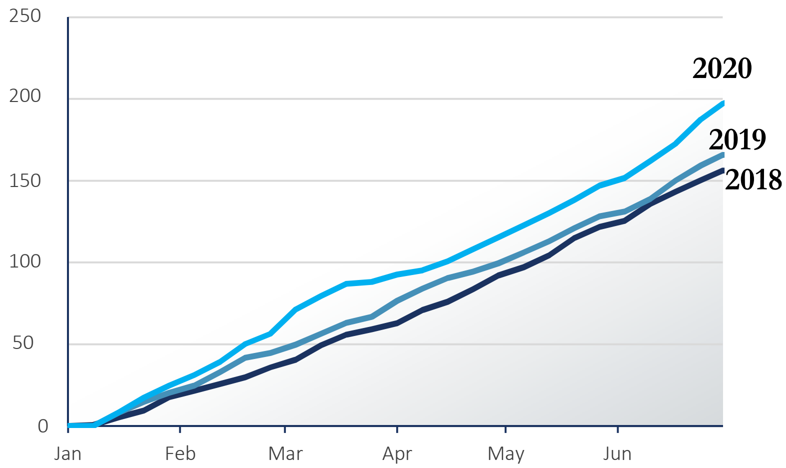
Performance Notes

The Bloomberg Barclays 1-15 Year Municipal Index posted a negative total return in April but had positive returns in both May and June bringing total return for the quarter to 2.69%. The Intermediate Maturity Municipal strategy outperformed the benchmark for the period with the overweight to highly-rated credits within highly-rated states as the primary driver. Supply appears to be normalizing following a freeze during the first months of the pandemic. We expect steady demand from retail and from an abundance of July 1 maturities and redemptions. We believe there will be some minor pushback from investors at these low absolute yields, however, we do not see a particular event pushing yields meaningfully higher over the near-to-medium term.

Total Municipal Issuance YoY ($Bln)

Source: Bloomberg



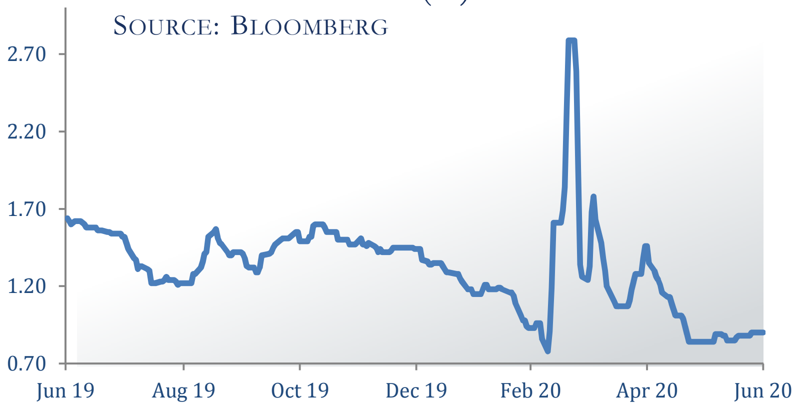
"We remain constructive on Munis as a whole at current levels,

especially when considering taxable-equivalent yields.

We remain judicious on credit selection and are overweight high-quality general obligation and essential service revenue bonds with sound financials. "

10 YR MMD Yield (%)

Source: Bloomberg



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