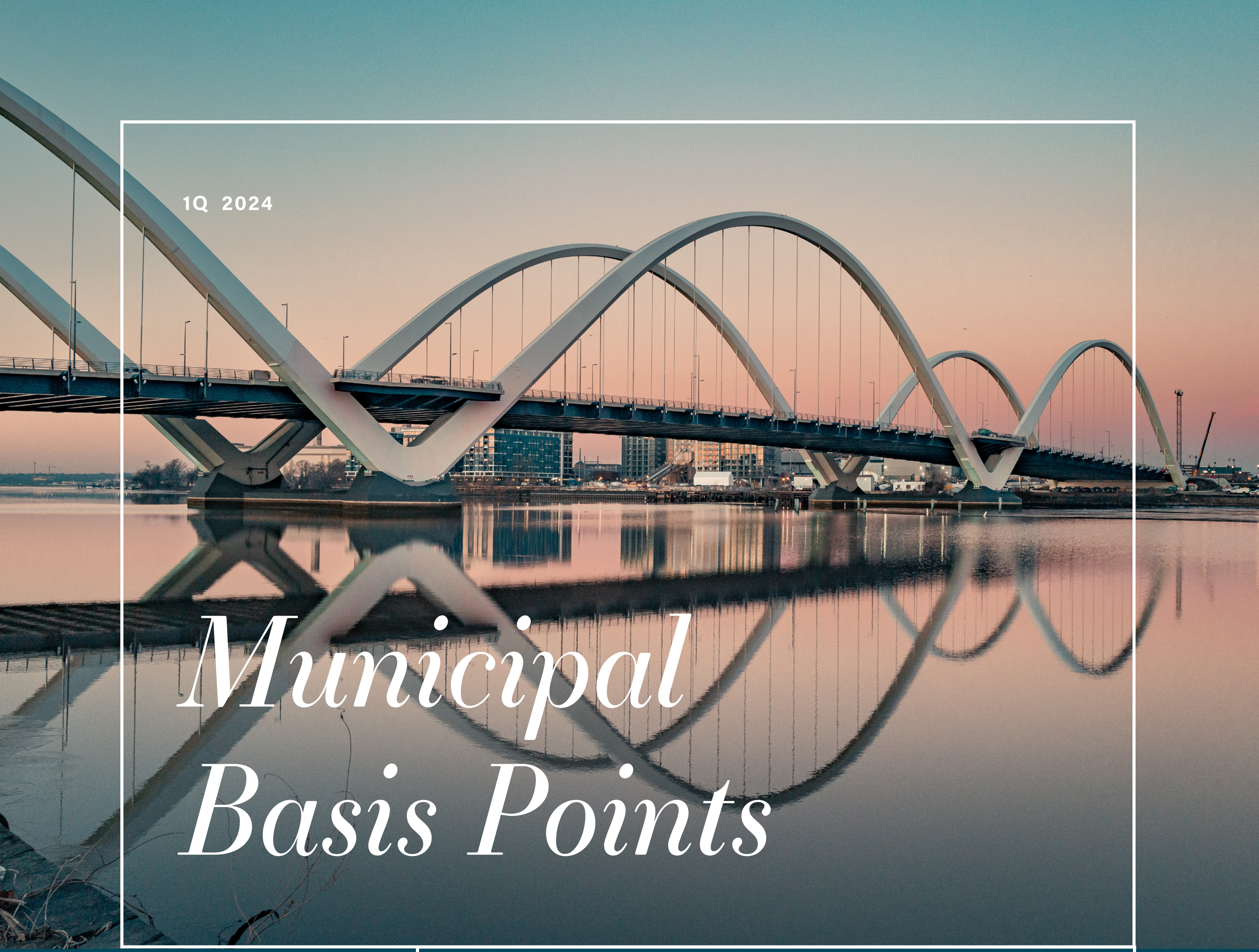

1Q 2024

Municipal Basis Points

MUNICIPAL FIXED INCOME TEAM

More to Go?

- We believe municipal yields remain attractive even after a blowout fourth quarter; now could be a time to put more money to work.
- Technicals should help municipal yields remain range-bound in the coming months, though the Federal Reserve may maintain current policy rates longer than many expect.
- Current conditions lend themselves to careful security selection; private tolls are among the sectors we favor.

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PRIVATE WEALTH

Macro and Markets

Even after a record rally, we believe the current opportunity in municipal bonds is substantial.

What a difference a quarter makes! Fixed income markets endured an extremely rough period from August through October as Treasury rates rose over 100 basis points due to continued strength in the economy, the Fitch downgrade of U.S. debt, expectations for heavy Treasury supply, and concerns about debt sustainability. As we entered November, market sentiment suddenly shifted in a positive direction as some inflation and employment data came in softer than expected, the Federal Reserve continued its interest rate pause and concerns around heavy debt issuance subsided.

Munis actually underperformed during the August – October Treasury selloff due to heavy fall supply. It's fair to say that munis were quite undervalued as we entered November, but quickly started to rally as some of the above factors signaled an "all clear" for investors. The full investment grade muni market, as measured by the Bloomberg Municipal Bond Index, returned 6.35% in November, one of the best total-return months in the market's history.

More to Go?

Despite a strong rally, we believe investors shouldn't feel like they've missed the opportunity to invest in munis. To the contrary, yields on investment grade munis are still over 200 basis points higher than they were at the end of 2021, and close to the yields that existed at the end of 2022. With more certainty around the Fed, we believe it is time for some investors to secure the higher yields available in today's market and to do so for a longer period of time.

In our view, there will continue to be pockets of volatility in 2024 as the market pores over every economic data point and tries to discern how the Fed will react. Those moments should provide an opportunity to deploy capital. Views will change as to when the Fed eases and what the pace of rate cuts could be, but we believe the path of rates is less important than the level where they may end up. In our view, the Fed will likely move from an overnight rate of around 5.5% currently to something that ultimately is closer to 3%, presenting a meaningful opportunity to take advantage of a higher-yielding market. As we said in the last edition of *Municipal Basis Points,* "it may be time to get into the game" and buy some munis.

Strategy and Outlook

We see opportunity in long-bond "roll-down," as well as benign technicals.

In the wake of stellar fourth-quarter municipal market performance, we see a number of implications for investors.

We have moved to a neutral view on duration positioning (sensitivity to interest rate fluctuations), given what we consider municipals' full valuation relative to U.S. Treasuries. Regarding the yield curve, we believe there is healthy total-return potential in the "roll-down" of longer bonds as they move closer to maturity; in particular, we see the 11- to 14-year area of the curve as optimal in this regard.

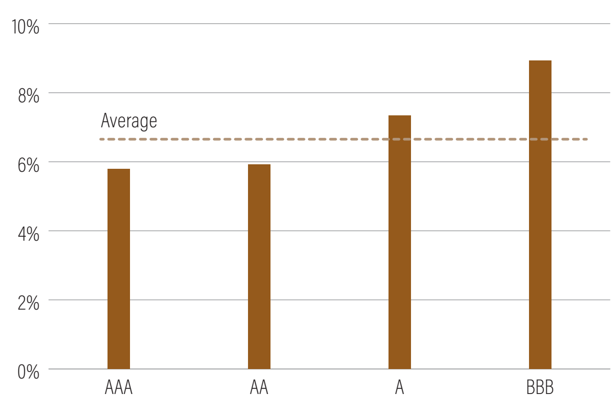
In our view, technicals favor investors at this point. The start of the new year has typically helped municipal performance due to the tailwinds of reduced new issue supply and investors reinvesting their coupon and maturity cash received. These dynamics could keep municipal rates range-bound in the near term. Increased issuance later in the quarter could open up more buying opportunities for alert investors.

In some ways, Fed policy remains a wild card. The central bank signaled at its November meeting that it was likely done hiking rates—a much-awaited "pivot" that drove the fourth-quarter market rally and record municipal performance. However, the job of constraining inflation is still not finished, and it's possible that the Fed could hold rates at current levels longer than many expect.

In this environment, we believe security selection will be a major driver of performance, particularly in the single A and BBB rated sectors. As always, our municipal research team will be looking for bonds that compensate investors with additional yield while exhibiting solid credit fundamentals.

2023 MUNICIPAL PERFORMANCE BY CREDIT QUALITY

Bloomberg Municipal Bond Index



Source: Bloomberg.

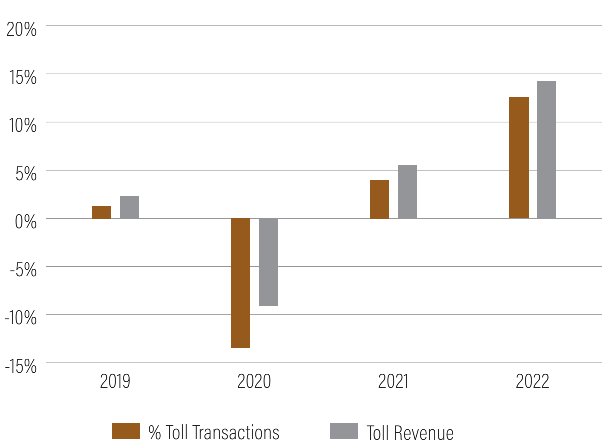
Deeper Dive

Why we are looking closely at private toll roads.

Our municipal research team has an important mandate to target investments with improving credit trends and attractive pricing. One area where we are currently constructive is the BBB privately managed toll-road sector, which has experienced strong transaction and revenue growth since the COVID-19 pandemic. While growth trends are likely to moderate to historical levels, credit fundamentals remain sound.

PAID AS YOU GO

Median Annual Toll Transaction and Revenue Percentage Growth (Fiscal Year 2019 – 2022)



Source: Standard & Poor's.

Fundamentally, most privately owned tolls are constructed in heavily congested regions that have benefitted from strong demographic and economic trends—something that has been critical to sustaining the sector's financial health. In addition, the toll systems typically feature dynamic pricing mechanisms to help regulate traffic trends, which supports their intended purpose of relieving traffic congestion.

In 2023, the BBB municipal sector outperformed its higher-rated counterparts, and today we remain diligent in seeking investment opportunities. With sound credit fundamentals and promising growth, privately managed toll-road sector stands out to us as a favorable prospect for future investments.

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