



Municipal Bond Market Update

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I think people really come to rely on munis for low volatility, and that's been what we've seen during the first half of this year.

The second quarter was a very good quarter for municipal bonds. But better than the strong performance has been the relatively low volatility. What's driven that performance? Well, treasury yields have fallen during the first part of this year, and munis generally act in sympathy with treasuries. As yields are falling on treasuries, munis follow suit.

The other thing that really is important for you to know is that the technical dynamic in our market, there's a lot of money in our market right now, muni yields are still very attractive, and there really isn't a lot of supply. So this supply, demand imbalance has been a big reason why we've had such strong performance year-to-date.

Certainly Puerto Rico got the lion's share of headlines during the quarter. I think vastly underreported is that municipal credit overall has stabilized. Overall we're seeing rating actions generally being positive, rating upgrades more than downgrades in our market.

During the first half of the year, really it was lower and longer did well. When I say longer, I mean the longer maturities did much better than the shorter maturities, and lower quality did better than higher-quality. There is an insatiable demand for yield in our market, and a lot of money recently has been coming into high-yield municipal bonds, so it's not surprising that lower rated, non-rated, and BBB bonds have done so well.

Foreign buyers have shown up in our market as we've never seen before. And I think it makes a lot of sense. There are negative yields on literally trillions of dollars of government debt. Many of these foreign investors are looking for opportunities to find reliable, dependable income. And of course, that would turn to munis. And the income on munis is very attractive relative to the negative rates they're getting overseas.

In terms of valuing our market, it's hard to tell whether we're fairly valued or not. A lot of it depends on what treasury rates do, and a lot of that depends on what happens with the world economy and the national economy. If rates continue to fall, you know, we could still see more price appreciation from here. I say that though, realizing that we are at historically low levels of yields on 10 year treasuries, 30 year treasuries, and municipal bonds. Given that dynamic, you know, going forward, it might be just that you're looking at the attractive yields on munis relative to what you can get in other markets, especially when you magnify that by the tax-exempt nature of the interest you're earning on municipal bonds.

Looking forward for the remainder of the year, we would expect that if you looked at your coupon on the bonds that you own or the securities in the fund that you own, that would be generally in line with where we would expect your return to be. We are not predicting that rates are going to fall tremendously from here. Having said that, we don't know what's going to happen in the world economy following Brexit, what's going on in China. Overall, world economic conditions will certainly drive treasury rates, so if treasury rates were to fall, you would see more than your coupon return, you would actually see some price appreciation. Putting that aside and presuming we end the year basically where we are in terms of the economy, coupon-like returns would be very much what I'd expect.

As an investor right now, my preference, because I actually believe we're going to be in the lower for longer environment in terms of interest rates, I'm not uncomfortable with the concept of being longer in duration right now, that I think that our market will be very resilient because I think treasury rates are going to remain lower for longer.

So I'm very sanguine about long-term prospects, and I would be interested in the longer end of our municipal yield curve.

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