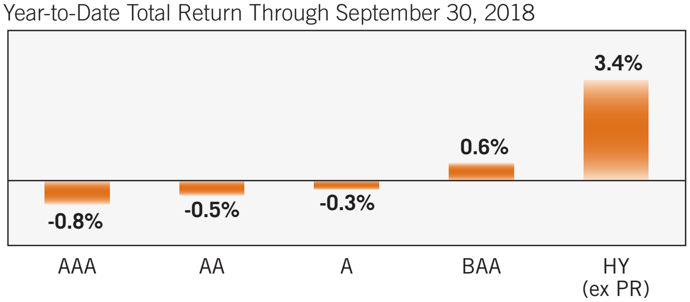
Municipal Bond Market

PERFORMANCE

The Bloomberg Barclays Municipal Bond Index posted a return of -0.15% in the third quarter, largely a result of the negative performance experienced during the month of September as municipal bond yields followed U.S. Treasury yields higher. For the three months ended September 30, 2018, the intermediate part of the curve produced positive performance while shorter and long maturity bonds underperformed with negative returns. Additionally, lower quality bonds once again outperformed higher quality bonds as investors were willing to take additional credit risk in their quest for higher yield. On a year-to-date basis, shorter maturity bonds maintained their lead over longer dated paper while lower quality bonds continued to outperform higher quality.

PERFORMANCE BY QUALITY

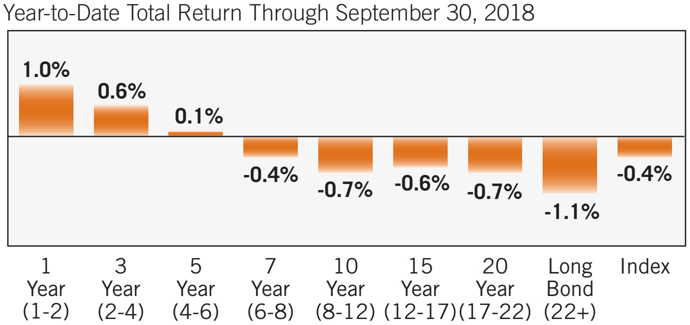
Bloomberg Barclays Municipal Bond Index
Year-to-Date Total Return Through September 30, 2018



Source: Bloomberg Barclays. **Past performance is no guarantee of future results.**

PERFORMANCE BY MATURITY

Bloomberg Barclays Municipal Bond Index
Year-to-Date Total Return Through September 30, 2018



Source: Bloomberg Barclays. **Past performance is no guarantee of future results.**

TECHNICALS

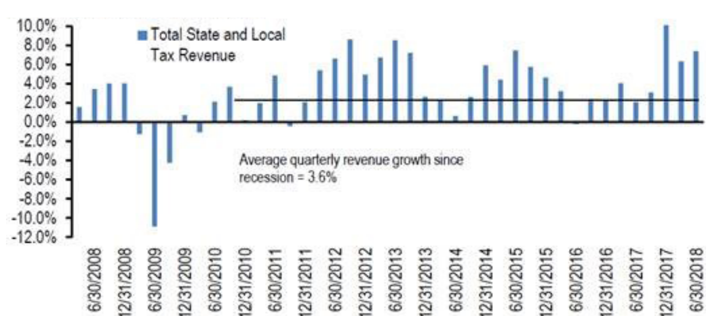
The municipal bond market continued to experience lighter new issuance during much of the third quarter, but the favorable technical conditions have softened as slower demand and rising U.S. Treasury rates resulted in negative performance for the quarter. Municipal issuers have been constrained to issue debt as the new tax code eliminated their ability to advance refund higher cost debt with new tax-exempt debt, while fiscal austerity measures have also made them reluctant to issue debt. Demand for municipals has been mixed as interest rates have risen and the new tax code has lessened the advantage for banks to own tax-exempt bonds. Individuals continue to invest in tax-exempt securities, favoring investments in tax-exempt mutual funds, ETFs, or separately managed accounts over direct ownership. Banks, on the other hand, which had become a sizable buyer of municipal bonds prior to the lowering of the corporate tax rate from 35% to 21%, have continued to reduce their exposure at a steady pace. While slower issuance had been able to offset slowing demand, even a slight increase in issuance later in the quarter caused performance to suffer. Overall, the technical picture for municipals remains supportive as lower supply has helped to offset some weakening demand. Looming concerns around an increase in supply levels and investor apathy as interest rates rise could disrupt the strong technical conditions that have been in place for much of the year.

FUNDAMENTALS

Credit fundamentals for the municipal bond market will remain challenged by high fixed cost burdens, including high debt loads and underfunded pension liabilities. However, a stronger housing market, an improving job market, and a continued general economic recovery should help to moderate some of the fiscal strain of pension burdens. While there have been several highly publicized events of struggling municipal credits, with the latest coming out of Puerto Rico, we believe that municipal bonds remain one of the lowest risk asset classes, with credit metrics for the majority of municipalities continuing to improve as the economy expands. This improvement is mostly due to a healthier tax base and better financial management, which has translated into higher revenues and replenished reserves. Although fundamentals have improved, thorough credit analysis is imperative in this market as issuers are not all created equal, even when they have similar credit ratings.

STATE AND LOCAL TAX REVENUE GROWTH

%, Total State and Local Tax Revenue Growth

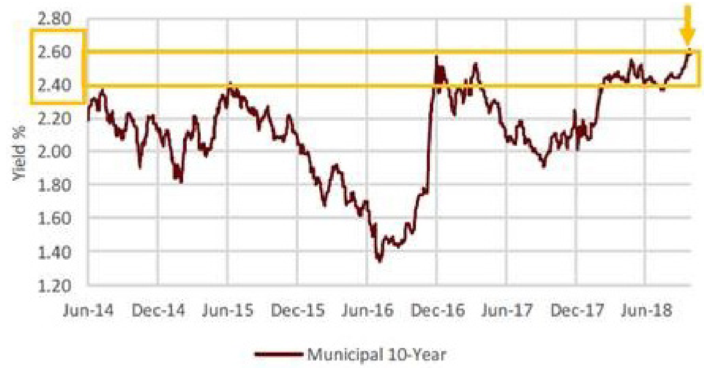


Source: Census Bureau, JPMorgan. As of 2Q18.

OUTLOOK

As we head into the final quarter of 2018, our outlook for municipal bonds remains cautiously optimistic. The current strong economy, rising rates, and strong equity market performance this year have seemed to moderate investor interest in municipal bonds. But valuations of municipal bonds appear increasingly attractive given the rising yields in 2018, especially when considering their taxable-equivalent yields compared to other fixed income investments. Market volatility is expected to increase throughout the remainder of the year, given the uncertainty of interest rates as well as the effects from the 2017 tax law amendments. The exhibit below shows that, while rates are rising, they have been in this range before. This occurred as recently as the fourth quarter of 2016, when expectations of faster growth and rising inflation following President Trump's election caused Treasury yields (and municipal yields) to surge. Finally, while overall market fundamentals have improved, we continue to believe that now is not the time to take on additional credit risk in the municipal market, especially with credit spreads at historically tight levels.

MMA MUNICIPAL 10-YEAR YIELD:
June 2014 to September 2018 – Support 2.40% to 2.60%



Source: Municipal Market Analytics

Authored by:

The Newfleet Municipal Bond Team

Newfleet leverages the knowledge and skill of a team of investment professionals with expertise in every sector of the bond market, including evolving, specialized, and out-of-favor sectors. The team employs active sector rotation and disciplined risk management to portfolio construction.

The Bloomberg Barclays Municipal Bond Index is a market capitalization-weighted index that measures the long-term tax-exempt bond market. The index is calculated on a total return basis. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.