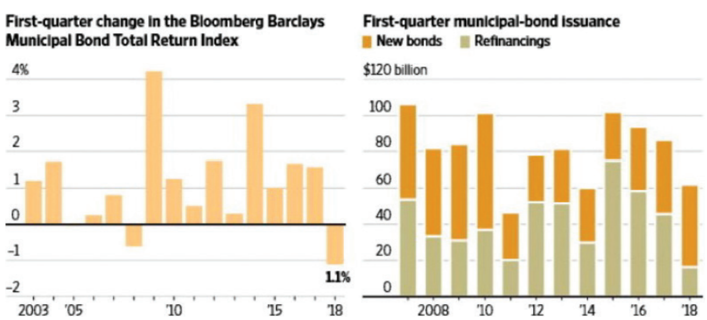
Newfleet ASSET MANAGEMENT
A Virtus Investment Partner

Municipal Bond Market

PERFORMANCE

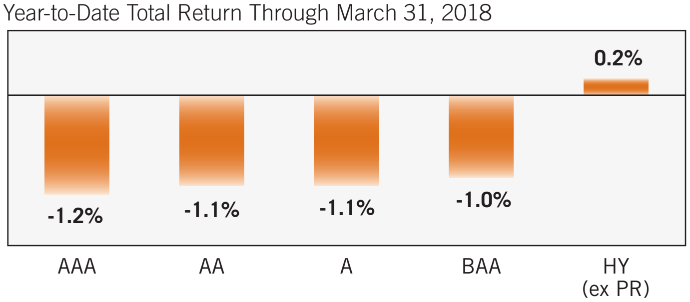
The first quarter of 2018 was marked by the reappearance of market volatility and the initial impacts of tax reform legislation. The Bloomberg Barclay's Municipal Bond Index posted a return of -1.1% in the first quarter, a weak start to 2018 following strong performance in 2017 (+5.45%). Despite the positive municipal market technicals (discussed below), market volatility and higher U.S. Treasury yields led to negative returns for the first three months of the year. The Index had not had a negative first-quarter return since 2008.



Sources: FactSet (Index); Thomson Reuters Deals Intelligence (Issuance). As published in the Wall Street Journal, April 2, 2018.

PERFORMANCE BY QUALITY

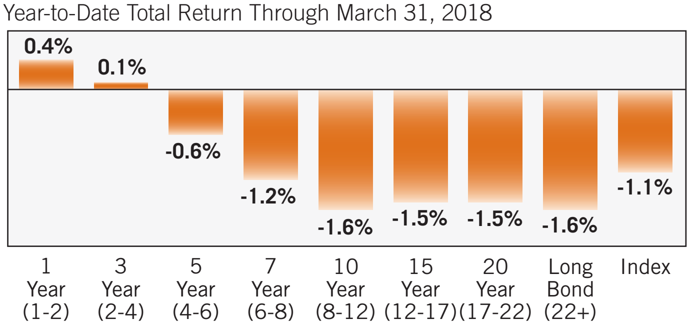
Bloomberg Barclays Municipal Bond Index
Year-to-Date Total Return Through March 31, 2018



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 March 31, 2018



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

In contrast to last year, there was little variation in performance among the investment grade rating categories with AAA rated bonds experiencing similar performance as BBB rated issues. Yield curve performance varied more sizably by maturity, with shorter maturing bonds outperforming longer-dated paper as overall interest rates have risen.

TECHNICALS

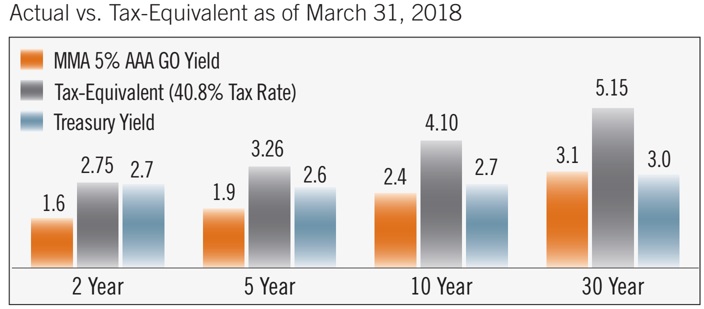
The technical picture for municipal bonds remains positive as the market continues to see lower levels of supply, which has helped to offset signs of weakening demand. The municipal market has benefited from reduced new issuance to start the year, as many municipal issuers took advantage of advance refunding their higher-cost debt at the end of 2017 before their ability to do so was halted due to tax reform legislation changes. This rush to get issuance completed before year end caused a sizable spike in supply levels in December, but has resulted in a much slower pace of new supply through the first three months of 2018. At the same time, weakening demand in the form of lower mutual fund flows and concerns surrounding future demand for municipals from banks and insurance companies with the lowering of the corporate tax rate to 21% have caused a more cautious stance on the market. Overall, the technical picture for municipals remains positive as lower supply has helped to offset some weakening demand.

FUNDAMENTALS

We continue to believe that municipal fundamentals will likely remain challenged by high fixed cost burdens. However, we are expecting some improvement in pension funding levels with the strength in the equity market over the past year, and higher revenues from growth in tax collections as a result of a stronger housing market. Although fundamentals have improved, thorough credit analysis is imperative in this market as all issuers are not created equal despite similar credit ratings.

MMA 5% AAA GO YIELDS

Actual vs. Tax-Equivalent as of March 31, 2018



Source: Municipal Market Analytics
Past performance is no guarantee of future results.

LOOKING AHEAD

Valuations of municipal bonds appear attractive given the back-up in yields, especially when considering the taxable equivalent yields. Market volatility is expected to continue in 2018 given the uncertainty of interest rates as well as the effects from tax reform. In particular, we will be watching for changes in municipal demand from banks and insurance companies. 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 historical tights.

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.