Newfleet
ASSET MANAGEMENT
A Virtus Investment Partner

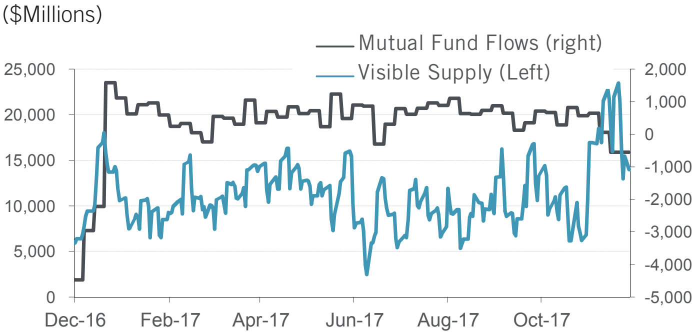
Municipal Bond Market

TECHNICALS

During the fourth quarter, events that historically would have sent the municipal bond market into a tailspin actually paved the way for a strong start to 2018. During the month of December, as tax reform made its way through Washington, municipal issuers were actively issuing bonds to avoid being shut out from the market in the new year. Facing the possibility that hospitals, universities, and other private activity bond issuers would no longer be able to issue debt in the tax-exempt market, issuers rushed to market. While this proposed element of the bill ultimately was not included in the final legislation, issuers were not taking a chance. At the same time, municipalities sought to refinance their higher-cost debt before their ability to advance refund it was halted. This rush to complete issuance before year end caused a sizable spike in supply levels. Instead of causing the market to soften, the anticipation of limited supply in 2018 provided strong performance heading into the end of 2017.

MUNICIPAL FUND FLOWS VS. 30-DAY VISIBLE SUPPLY

($Millions)



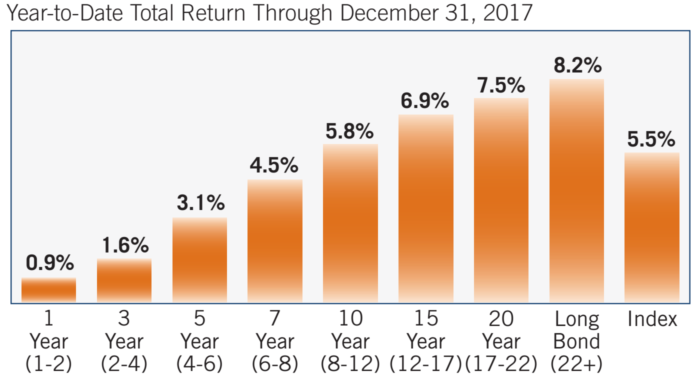
Source: MMD, Bloomberg, IPREO, ICI, Bond Buyer, Piper Jaffray & Co.
Past performance is no guarantee of future results.

PERFORMANCE

The Bloomberg Barclays Municipal Bond Index posted a return of 0.75% for the quarter, adding to the full-year performance of 5.45%. Performance was strongly correlated to positioning along the yield curve as longer-maturity bonds sizably outperformed shorter-maturity bonds. With the Federal Reserve starting to unwind its quantitative easing program and raising its benchmark rate for the third time in 2017, yields on the front end of the curve rose while limited supply in the long end caused yields in that part of the curve to decline. The result was a flatter yield curve. In addition, lower-rated issues continued to outperform higher quality alternatives (for both the quarter and the year) as municipal investors still favored yield, causing credit risk spreads to remain historically tight. In most cases, we do not believe that investors are being appropriately compensated for buying lower-rated issues as municipal bond fundamentals continue to be challenged by high fixed cost burdens, pension liabilities, and healthcare expenses, especially if we are headed into a late economic cycle.

PERFORMANCE BY MATURITY

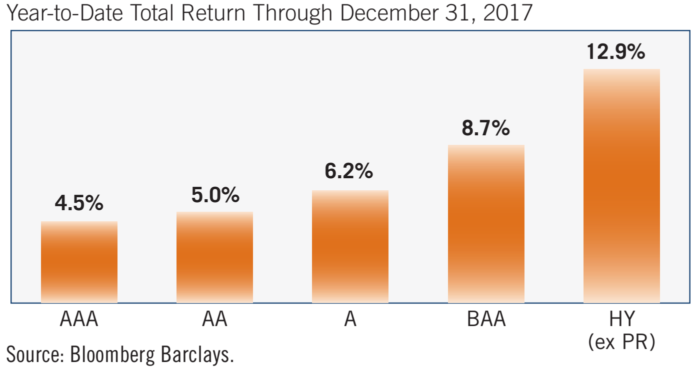
Bloomberg Barclays Municipal Bond Index
Year-to-Date Total Return Through December 31, 2017



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

PERFORMANCE BY QUALITY

Bloomberg Barclays Municipal Bond Index
Year-to-Date Total Return Through December 31, 2017



Source: Bloomberg Barclays.
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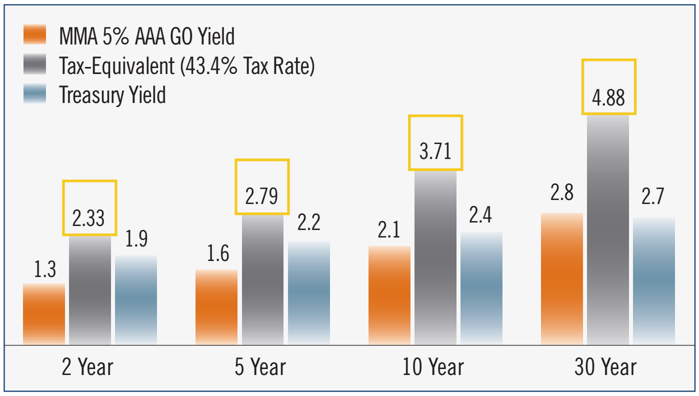
TAX REFORM

With the passage of the tax reform bill now behind us, we will need to monitor how lower tax rates may affect the demand for tax-exempt bonds. For individuals, municipal securities will likely continue to offer attractive taxable-equivalent yields and solid demand should continue. The bigger question is how the new 21% corporate tax rate will affect demand by banks and insurance companies that have been strong buyers of municipal bonds. While most observers anticipate slowing demand, outright liquidation of municipal portfolios by the large institutional buyers seems unlikely.

MMA 5% AAA GO YIELDS

Actual vs. Tax-Equivalent as of December 29, 2017



Source: Municipal Market Analytics

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OUTLOOK

As we continue to assess the impact that tax reform will have on the municipal bond market, we believe that the market is positioned to perform well. Limited supply to start 2018 should prove to be quite bullish for bond evaluations, unless Treasury yields spike higher and cause investors to become leery of the broader bond market. With credit risk spreads at historically tight levels, we also believe that now is not the time to take on credit risk in the municipal market. Fundamentals remain challenged for many municipalities, so we continue to focus on higher quality investments. Thorough credit analysis is imperative as not all issuers are created equal.

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.