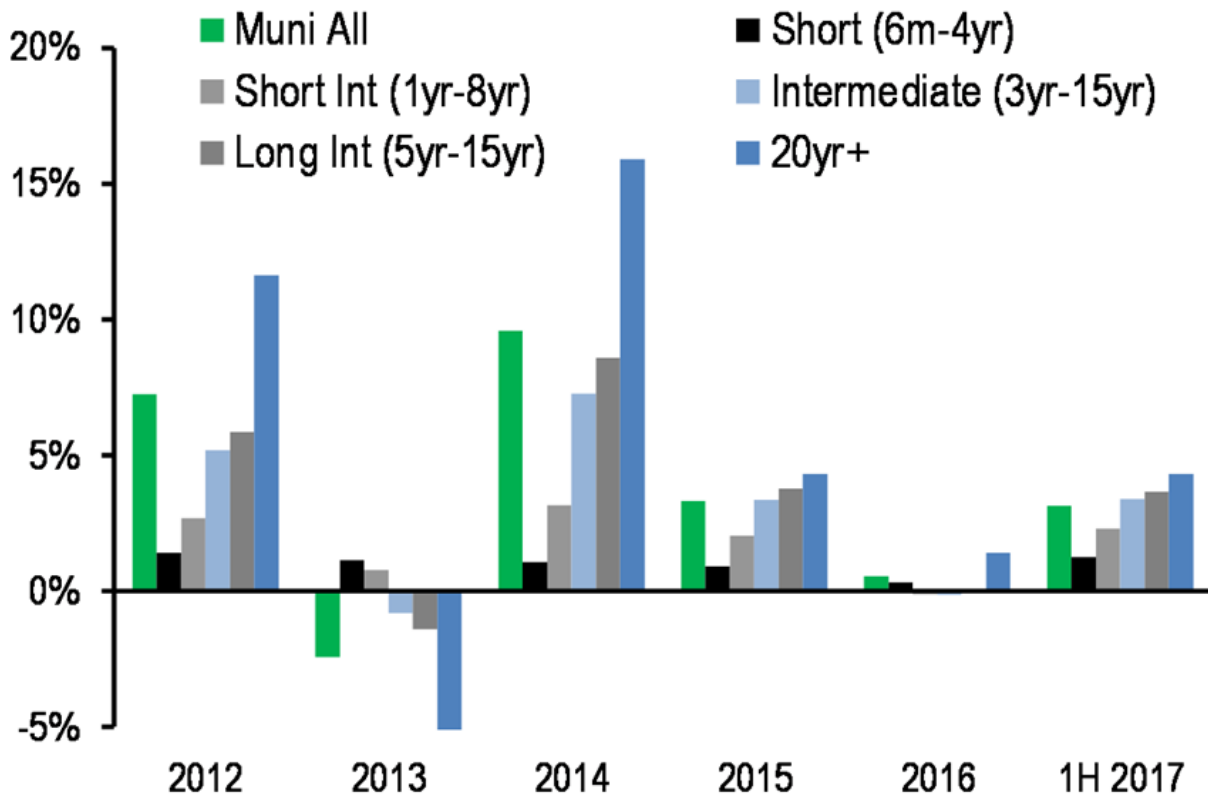




Municipal Update 7/25/17

First Half Performance, State Tax Revenue Decline, Illinois Avoids Downgrade, Midyear Muni Ideas

What worked best in the first half? Once again, the long end outperformed:



Source: Bloomberg, S&P, JP Morgan. S&P Indices used to calculate returns.

Healthcare edged out other sectors, despite concerns over potential Affordable Care Act changes:

	Muni All	Power	Water & Sewer	Higher Ed	Health Care	Airport	Transport	Housing
2012	7.2%	5.2%	7.5%	7.9%	10.7%	8.3%	7.6%	7.1%
2013	-2.4%	-3.1%	-2.9%	-2.6%	-2.5%	-2.0%	-2.7%	-0.3%
2014	9.6%	7.0%	10.8%	10.9%	13.1%	11.4%	11.5%	9.5%
2015	3.3%	4.6%	3.9%	3.8%	4.6%	3.8%	3.7%	3.7%
2016	0.5%	0.8%	0.3%	0.3%	0.9%	0.6%	0.5%	1.3%
1H 2017	3.1%	2.6%	3.2%	3.7%	3.8%	3.7%	3.6%	3.2%

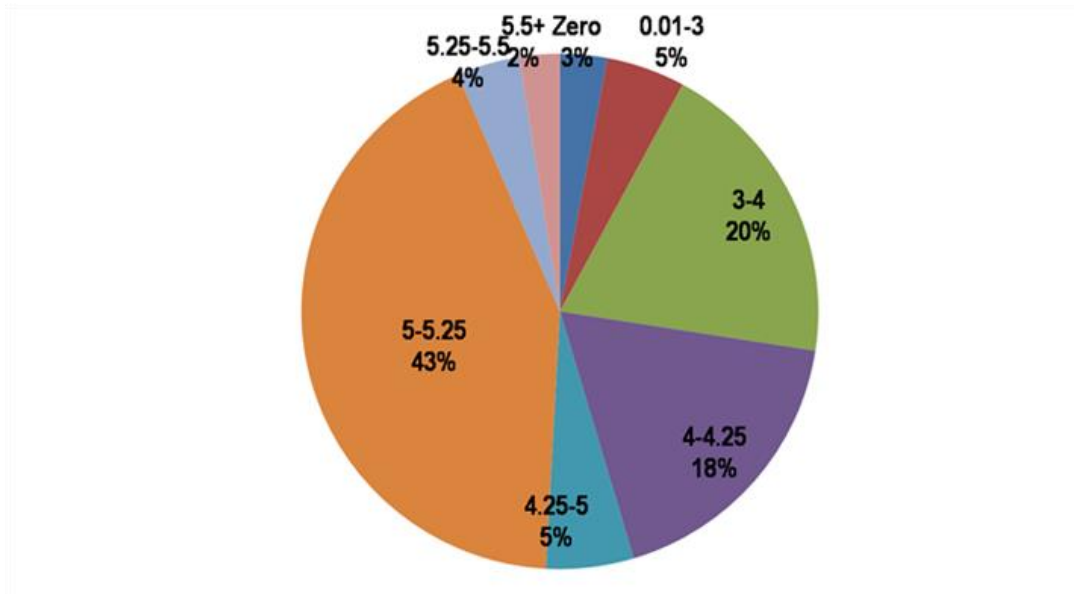
State Tax Revenues Decline and Illinois Manages to Avoid Junk:

Rockefeller Institute of Government tax data confirmed a national theme of tax pressures. Personal income tax revenues for April YOY (2016 to 2017) fell 4%. The number of negative watch standings of several states is forcing some inquiry into state revenue names and/or local revenue credits where tax implications aren't a factor. Revenue bonds with dedicated payment streams are increasingly favored in the market.

Illinois avoided becoming the first junk-rated U.S. state last week after Moody's confirmed the state's Baa3 rating, the lowest investment grade. This occurred after the legislature overrode Governor Bruce Rauner's veto this month to enact the first budget in two years. Although the immediate threat of a downgrade was eased, the outlook is still negative. Moody's said in a statement, "While budget passage alleviates immediate threats to the state's credit, long-term challenges remain." The \$250 billion unfunded pension liability has not been addressed.

High Coupons Favored:

Through May 2017, 5.00%-5.25% coupon structure comprised 58% of new issuance and represented 43% of secondary market trading volume:



Institutional investors in particular prefer high coupons.

Mid-year Suggestions:

- For investors seeking additional yield a bit lower on the muni the credit spectrum, counter this exposure with shorter maturity high grades to balance credit and duration profile.
- Consider higher coupon, premium bonds with shorter calls “kickers” to generate additional yield, and for their defensive characteristics.
- Create a barbell with longer duration bonds and VRDN floating rate issues. Between the past year of Fed rate hikes and the smaller size of tax-exempt money market funds, VRDN’s are worth a look.

- Include bonds in the lower end of the high-quality range. While the additional incremental spread in moving from AAA down to AA will be slight, consideration of credits in the A rated may open up more opportunity.

Please feel free to contact us anytime if you'd like to discuss the topics cited in this update, or any others related to the municipal bond market.

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