16ᵀᴴ AMENDMENT ✚ ADVISORS LLC℠

A Good Time to Credit Up?

Over the past several years, the credit quality of municipal bonds has been quite stable. This reflects the general strength of the economy and the resulting strong tax receipts, as well as the significant stimulus money advanced to states and cities due to the pandemic. To start 2023, municipal mutual fund flows have been positive in part due to the perceived credit strength. As we sit here today and look into our crystal ball, we can see a reversal of this trend. The State of CA, City of Chicago/State of Illinois and the State/City of NY are all dealing with large budget gaps. They are not alone. We would note that there is broad economic consensus that there will be some form of recession in late 2023 and early 2024 potentially exacerbating these early warning signs. While most have ample resources and levers to deal with these shortfalls in the near term, as time progresses, we would expect some amount of credit deterioration to develop.

Given this backdrop, we believe now may be a unique time to "credit up" your portfolio. While we are not recommending a wholesale repositioning, we do think it's a good idea to focus selectively on credits that are likely to be more sensitive to economic deterioration and to transition to credits that have much better bondholder protections. You can accomplish this with very little to no yield give up. Here are some examples:

NEW YORK

Sell NYC GOs, Buy NYC TFAs

Sell NYC GO	5.00% 2047 @ 3.62 (MMD +50)	64966QXW5 Aa2/AA
Buy NYC TFA	5.00% 2/1/47 @ 3.55 (MMD +43)	64971XU71 Aa1/AAA

Rationale: TFA's are backed by a lien on income and sales taxes. The 7 bp spread is too tight and could widen in a credit challenged environment.

CHICAGO AND ILLINOIS

Sell Chicago GOs/BOE or IL GOs, Buy STSC

Sell Chi Board of Ed	5.00% 12/1/47 @ 4.98 (MMD +188)	167505YB6 BB/BB+
Sell Chi GOs	5 ½% 1/1/43 @ 4.50 (MMD +150)	167486P86 Baa3/BBB+
Sell IL GO	5 ½% 3/1/47 @ 4.38 (MMD +126)	452153DB2 Baa1/BBB+
Buy STSC 5.00%	1/1/44 @ 3.97 (MMD+94)	79467BFB6 AA-

Rationale: Similar to TFAs, Sales Tax Securitization Corp bonds are backed by sales taxes; further, the city of Chicago and the state of Illinois are traditionally poor credits and are too rich given the likely credit deterioration in our view.

CALIFORNIA

Sell California GOs/California Appropriated debt, Buy California Local School district bonds

Sell Cal St GO	5.00% 2047 @ 3.22 (MMD +20) 13063DP44 Aa2/AA-
Sell Cal Pub Works (Cal approp.)	5 ½% 1/1/43 @ 4.50 (MMD +150) 167486P86 Baa3/BBB+
Buy Oak Grove Sch District CA	5.00% 2052 @ 3.58 (MMD +39) 6712055K4 Aa3

Rationale: Local credits, particularly school districts, are supported by property taxes and/or state revenues. Like the City of New York, the current spreads are too tight given the economic prospects in our view.

While we focus on three large states, this does not suggest the potential for concern is limited to New York, Illinois, and California. This is a potential concern that can appear across a variety of states and municipalities. In the end, given the strong recent performance, the time is prudent to consider a credit upgrade across one's portfolio.