U.S. MUNICIPAL BONDS

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U.S. Tax Day Update 2023: Absolute rates or rich ratios?

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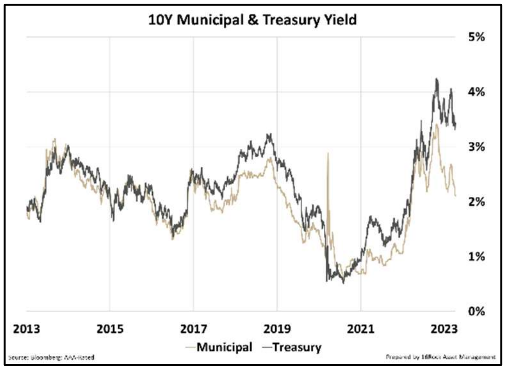
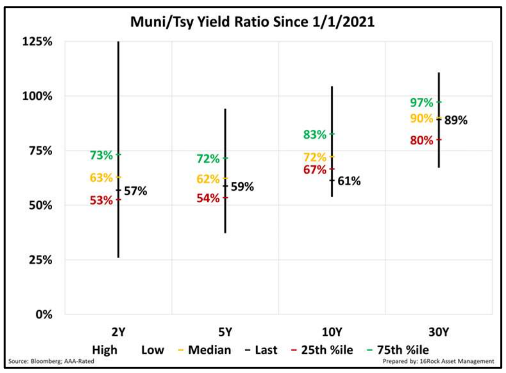
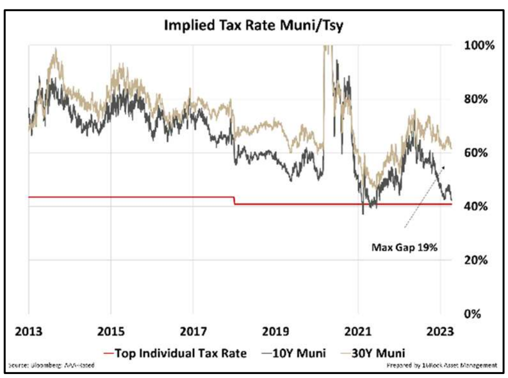


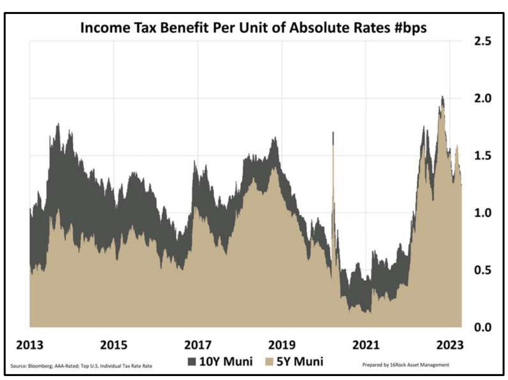
- **Narrow path to a soft-landing** for the U.S. economy was a narrative that started months ahead of the most recent issues. The financial economy is leading the real economy and stickier inflation concerns seem to have peaked with max rates, last year. The debate around the Fed, inflation, and recession will likely keep volatility elevated and momentum for rates trending lower.
- **Regime shift for fixed income** is underway with munis outpacing the move after a dismal 2022. Flows have switched back to positive and retail, the markets core buyer, is sending a powerful message with high grade short-intermediate maturities performing best.



- **Muni/Tsy ratios are near local rich levels** across most maturities, and much has been said about how expensive the asset class is. However, the technical backdrop is strong highlighted by slow supply growth, positive flows, and sturdy credit fundamentals, despite peak rating risk.
- **Technical perfection likely will continue** to be driven by inflation drag, rich budget reserves, and 2018's elimination of the advance refunding option. New exempt supply is expected to remain challenged, while lower rates help inspire more taxable muni issuance, technical positive for both assets. Taxable munis at corporate equivalent yields are attractive from a global perspective, especially short maturities and considering all the assets regulatory capital efficiencies.



- **Implied tax rates are near parity** for AAA-rated exempt credits, across most maturities, from the perspective of top U.S. individual income tax rate payers. The long-end is the exception where the macro debate has created the most uncertainty. The implied tax rate out long is still well above parity and trading at a peak gap relative to other shorter tenors.
- **Good reason to extend out the curve** all considering. Individual tax provisions are expected to sunset in 2025 and while 2018's corporate tax reform created an institutional buyer gap, market inflows are hitting income not total return fund types. Busted structures can also help maximize return potential such as, discount coupon, new money, short call, revenue bonds, within the same credit sphere.



- **Absolute rates trump rich ratios.** What's different about today is the magnitude of the exemption from the perspective of top U.S. individual tax rate payers. High absolute rates have a more powerful multiplier effect despite the optics of rich ratios. Much different than yesteryear's cheap ratios at low absolute rates.
- **Cyclical to defensive credit switch** is occurring within fixed income and for munis, top tax states such as California & New York should benefit most. Opportunities are best in monopolistic infrastructure credits, with rate-setting autonomy, that spread risk across a diverse customer base, with proactive and disciplined management, such as multi-state highway systems, and multi-family housing, in sustainable geographies, and under-supported communities.