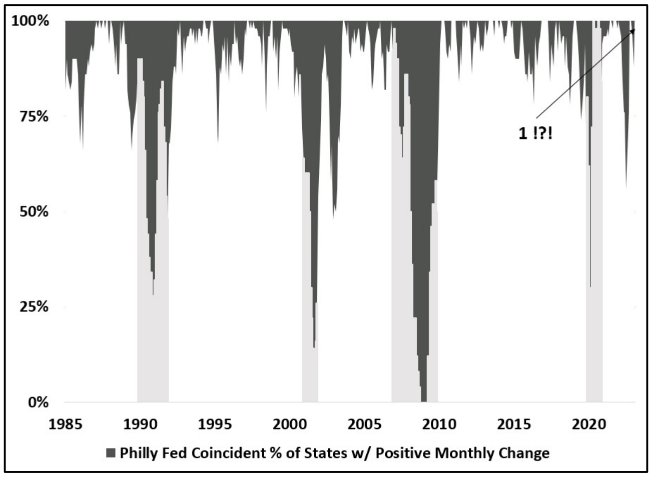
The Great Reset seems to be unfolding faster than we originally thought, a theme highlighted in this week's podcast for *The Bond Buyer*. Concerns about large layoffs, compensation compression, automation, and the restructuring of businesses were better quoted by the FOMC this week: *"tighter credit conditions for households and businesses are likely to weigh on economic activity, hiring, and inflation."* 10Y USTs broke 3.40% in the face of another quarter-point hike. Less than twenty-four hours after the regional banking crisis was declared 'over', the sector took another hit. We believe we are at or near peak terminal rate and prospectively we see UST rates moving significantly lower and the yield curve steeper. The 16Rock team debated several key topics at this week strategy meeting from a macro perspective: Is the regional banking crisis the canary in the coal mine? How many businesses were built to withstand today's high Fed funds rate?... We highlight our municipal topics at the end of this report.

[1] COMPANIES FOCUSED ON EFFICIENCY

Source: Bloomberg as of March 31, 2023

Cyclical to defensive credit switch is a trade we've executed across portfolios. That means up the capital stack favoring senior over subordinated debt, geographically underweight pension states, and overweight energy and commodity states, overweight revenue bonds versus general obligation debt (GO), and we're long duration at both ends of the yield curve. States and public schools are favored over locals in the GO space and infrastructure with rate setting autonomy in revenue bonds such as water & sewer. AGO and BAM insured bonds are preferred, select discount coupon structures, and bond with positive convexity such as non-call bonds.

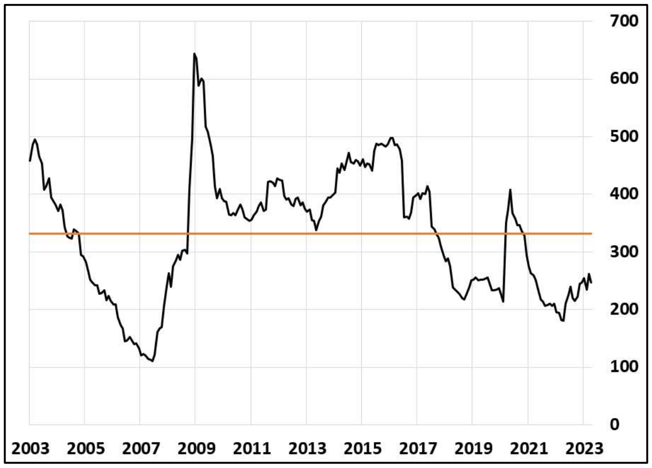
[2] PHILADELPHIA FED COINCIDENT INDEX % OF STATES W/ POSITIVE MONTHLY CHANGE



Source: Bloomberg as of March 31, 2023

Municipal high yield is rich to investment grade, and we're also moved up the rating curve. The Great Reset is signaling a peak rating cycle. We are underweight Senior living and workout situations such as Puerto Rico we do not own. In our portfolios that have a high yield allocation, we prefer Tobacco bonds and Project Finance with strong corporate-backed sponsorship. While we're bullish on the post-bankruptcy world for Puerto Rico, Detroit is an everyday reminder to never bet against a State or Local government that provide essential services, has nothing but time, resources, taxpayers and pension beneficiaries, and an ability to change law on their side.

[3] MUNI TAX-EXEMPT INVESTMENT GRADE VS HIGH YIELD



Source: Bloomberg as of May 3, 2023; #Basis Point Yield Spread of Bloomberg Municipal Bond Index Vs. Bloomberg Municipal High Yield

SVB/Signature Bank municipal bond sales commenced this week starting with the $400M taxable municipal bond portfolio. Tax-Exempt sales are said to follow in the next one to two weeks. Taxable municipal sales are being conducted over MarketAxess (MKTX). This is an electronic, multi-dealer to client platform for U.S. and European high-grade corporate and emerging markets bond trading. The Company's technology delivers price discovery and trade execution services to institutional and broker-dealer clients. No doubt this was a great decision and positive for the market; to use the platform and to start with taxable municipals before tax-exempts.

Relative value like this doesn't come around too often. The size of the taxable municipal bond sale is small and very good for price discovery. It's just too bad for the market that all $7b is not taxable municipals otherwise all would have traded in a heartbeat. The asset class has broad global appeal in today's environment as noted in our recent reports. The duration, quality, and diversification benefits of the holdings, at corporate equivalent yield, serves up a long-term opportunity at a time when the new issue market does not. The decision to go bid-wanted on this portion of the portfolio, and not work the bonds on a situational basis, creates a positive tone ahead of the tax-exempt sales in one to two weeks. We highlight a trade this week that speaks to what we're talking about; Texas State versus Walmart.

[4] TEXAS STATE 4% 10/2029 VS WALMART 3.25% 7/2029

Source: Bloomberg

SVB/Signature Bank tax-exempt sales are the big question mark. Whether the liquidation is executed on a situational basis or bid-wanted, we do not believe this will impact the overall municipal market. The municipal market is a regional based system designed around where U.S. wealth is greatest and taxes are highest such as California and New York. The tax-exempt market consists mostly of individual not institutional investors, especially true today post 2017 U.S. tax reform. Regional broker-dealers are a key source of liquidity, but many do not have a balance sheet to warehouse risk. Bid-wanted otherwise is an excellent process for tax-exempt sales, however in this case it does not provide enough time for regional broker-dealers to participate. Structure, liquidity and de minimis tax risk of the holdings warrants patience and implementation of individual line-item sales. We do not believe there is a block buyer in the market for the tax-exempts nor do we think reverse inquiry exists for the structures unless the global community and municipalities are engaged.

So many questions surround the $200 billion acquisition of First Republic Bank (FRC) loans and assets by JPM. Here are a few topics discussed at 16Rock's weekly strategy meeting:

Were there any knock-on regulatory benefits? Were the bonds acquired at original cost or current market prices? Will the bonds be held in the hold-to-maturity (HTM) or available-for-sale (AFS) portfolio? Is JPM over exposed now to the asset class given the 2% de minis rule? If not over-exposed what if any other sectors or credits gets sold to diversify risk? What does this mean for bank regulation going forward? How will political risk change in the coming months? Does this revive too-big-to-fail? Will Basel III get modified? What does this mean for lending and U.S. growth? How will the rating agencies respond? Where are the pain points, who got wiped out? How will this impact the bank-qualified (BQ) market and new issue supply? Will this impact borrowing cost for municipalities and U.S. tax-payers? What does this mean for the muni curve and the demand side of the equation? Who participated in the SVB sales? What did the depth and breadth of that look like?...

Our views on these questions will continue to evolve as more information becomes available. As always, we welcome the opportunity to speak with you about the municipal market and how we might be able to help.

16ROCK ASSET MANAGEMENT

16Rock is a full-service asset management firm specializing in U.S. Municipal Bonds with a global perspective. We cater to the modern needs of institutions and high-net-worth individuals around the world. Our passion is to help clients translate their desires and aspirations into sophisticated outcomes that exude order. Our team leverages decades of experience to construct highly curated portfolios. We offer tailored managed account solutions, transition management services, and through our alternative investment capabilities, products designed to deliver absolute return excellence.

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