ASSET PRESERVATION ADVISORS

MARKET COMMENTARY

Q4 2023

CARING FOR CLIENT PORTFOLIOS, BOND BY BOND.

FOURTH QUARTER HIGHLIGHTS

- October economic data prints suggested continued resilience in the US economy and pressured yields to move higher for the month as the market adjusted to the idea that rates would remain higher for longer.
- Sentiment reversed in November as yields moved decisively lower over the month on softer-than-expected inflation readings and a seemingly more dovish Federal Reserve. Market participants began to price for increased rate cuts in the first half of 2024.
- Per broad market indices, in November, municipals saw the best monthly performance showing in over 40 years.
- In December, the municipal market sustained the impressive rally that began the month prior, with yields continuing their downward trend on the growing consensus of an earlier commencement and a faster pace of easing by the Federal Reserve.
- For the fourth quarter, AAA-rated municipal yields declined by 92-119 bps.
- Municipal mutual fund outflows continued over the fourth quarter, though at a more muted pace. For the year, municipal mutual funds lost assets of $18 billion. By contrast, municipal ETFs recorded inflows of $15 billion, signaling a shift in investor preference for ownership within the asset class.
- After lagging significantly behind last year's pace for much of 2023, municipal market issuance picked up in the fourth quarter. New issuance supply totaled $99.8 billion in the quarter, bringing year-to-date issuance to $380.5 billion, just a 2.6% decline over the prior year.

QUARTERLY MARKET UPDATE

October economic data prints suggested continued resilience in the US economy. The release of the Q3 GDP showed a robust growth rate of 4.9%, while retail sales and durable goods reflected solid readings as well. Furthermore, the employment report released at the beginning of the month showed an increase of 336,000 jobs, handily beating expectations.

The broadly positive economic figures pressured yields to move higher for the month as the market adjusted to the idea that rates would remain higher for longer. This provided a challenging environment for municipal yields, though tax-exempts did outperform the move higher in Treasury rates. For the month, 2, 5, 10, and 30-year Treasury yields moved higher by 4, 22, 29, and 31 bps, while the stated AAA-rated muni spots moved higher by 1, 10, 16, and 23 bps, respectively.

October's new issue supply exceeded expectations, reaching $38.9 billion, a 25% increase over the same period last year.

On the credit front, the trend of positive rating agency action continued. Notably, the City of Chicago and the New York Metropolitan Transportation Authority (NY MTA) received one-notch upgrades on improved credit profiles for both issuers.

In November, financial markets witnessed a significant shift as yields moved decisively lower, marking a sharp reversal from the trend of the previous three months. Softer-than-expected inflation readings, though notably still above the FOMC's stated target, coupled with a seemingly dovish Federal Reserve, helped drive yields lower on the prospect that the Fed had concluded its tightening campaign and would begin to cut rates in the first half of 2024, with multiple cuts being priced in. For the month of November 2, 5, 10, and 30-year Treasury yields declined by 34, 51, 51, and 50 bps, respectively.

This development provided a favorable tailwind to the municipal market, as AAA-rated MMD yields declined by 88-97 bps over the course of November. This substantial move lower in yields propelled the asset class to its best monthly performance showing in over 40 years and erased the negative returns witnessed over the preceding several months. As measured by the Bloomberg Municipal Bond Index, broad market municipal returns stood at an impressive 6.4% for November, underscoring the dramatic turnaround in sentiment and market conditions.

Of note, the reversal in sentiment and the prospect of rate cuts caused a flurry of trading activity, as the Municipal Securities Rulemaking Board (MSRB) reported 1.5 million trades in November, a monthly record for the asset class.

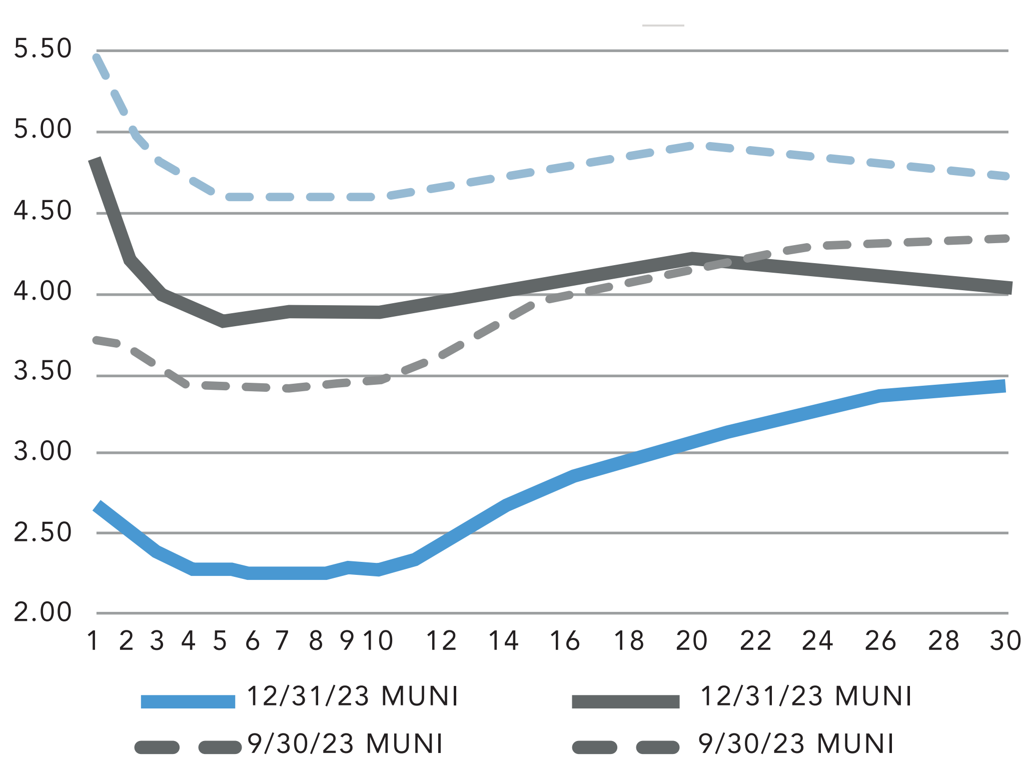
In December, fixed income markets sustained the impressive rally that began the month prior, with yields continuing their downward trend. This persistent strength in fixed income performance was driven by the growing consensus of rate cuts in 2024 and the market's anticipation of an earlier commencement and a faster pace of easing by the Federal Reserve.

During the December Federal Open Market Committee (FOMC) meeting, the Federal Reserve again held interest rates steady, aligning with market expectations. However, the Fed made significant adjustments to its 2024 "dot plot," signaling a more accommodative stance ahead. Chair Jerome Powell's remarks during the subsequent press conference reinforced this dovish sentiment, leading to a sharp decline in interest rates on the heels of the December 13th meeting. In the municipal market, yields experienced a notable decline of 33-41 basis points (bps) over the month, with the most significant drop occurring in the 7-10-year maturity range, as investors rushed to lock in yields in the intermediate part of the curve.

Municipal new issue supply totaled $24.3 billion for the month, a 20.8% increase over the same period in 2022. This marked the fourth consecutive month where new issue supply outpaced the previous year.

On the credit front, both Moody's and S&P elevated the state of Ohio's General Obligation (GO) rating to AAA ahead of the state’s planned issuance of approximately $393 million in refunding bonds.

MUNI & TREASURY YIELD CURVES



Source: Municipal Market Data, US Treasury

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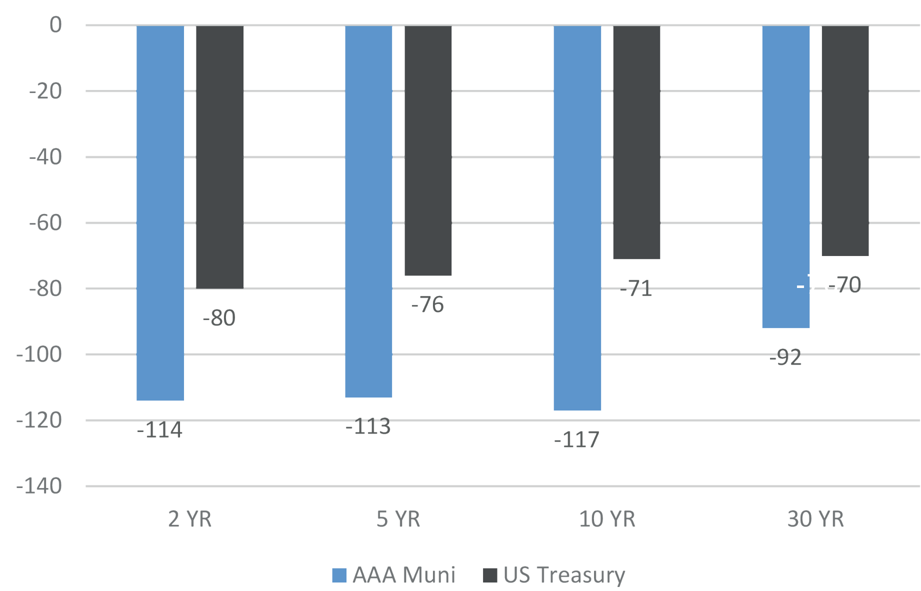
Q4 2023 YIELD MOVES (bps)

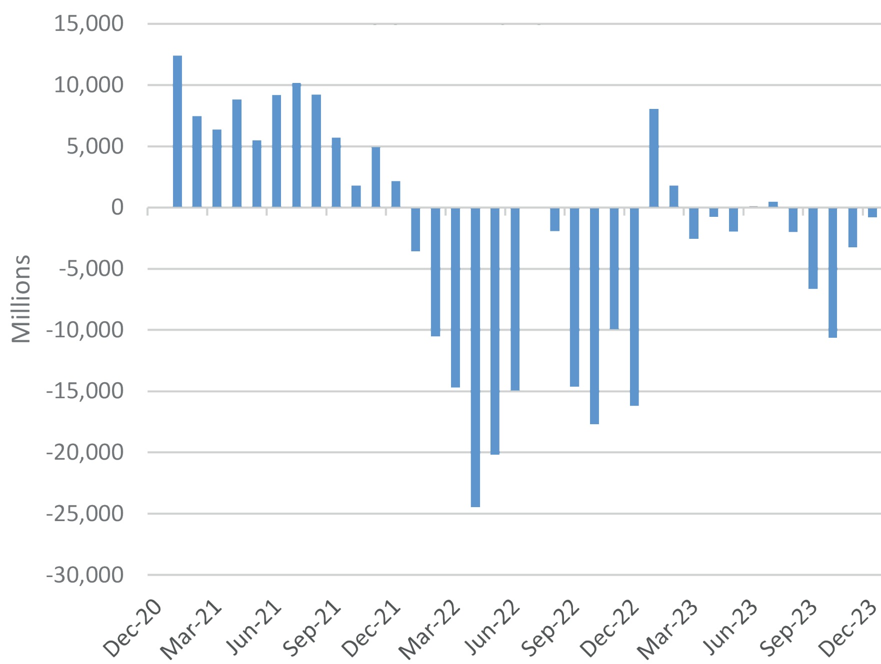


Source: Municipal Market Data, US Treasury

FUND FLOWS

Municipal mutual fund outflows continued over the third quarter. The Investment Company Institute (ICI) reported ten consecutive weeks of outflows to close the period. For the quarter, aggregate fund outflows totaled $6.9 billion. The changing supply/demand dynamic heading out of summer caused tax-exempt relative values to reset higher after being stretched at historically tight levels, a positive for new investors on a relative value basis.

MONTHLY FUND FLOWS

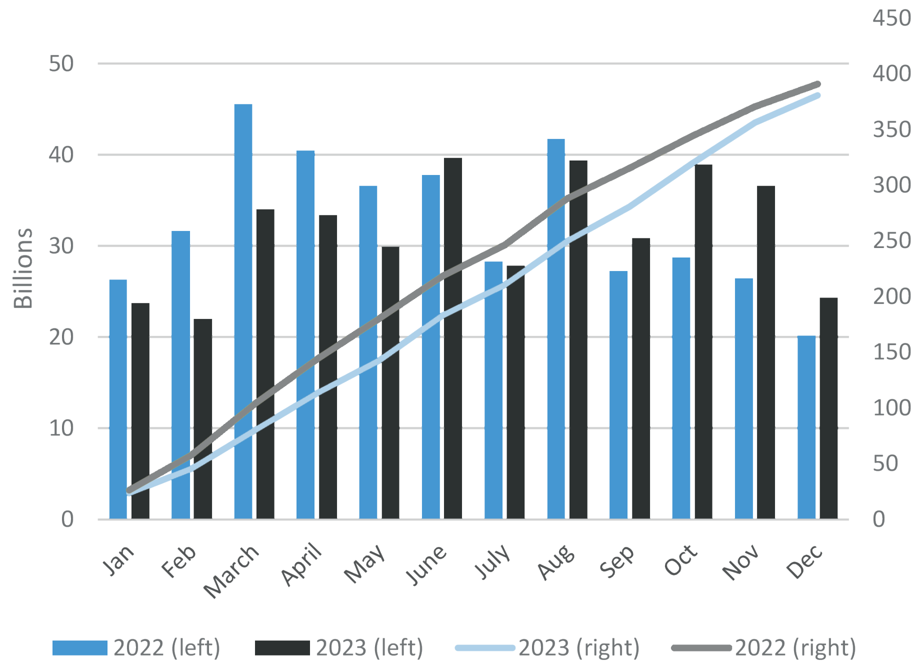


Source: ICI, Barclays

SUPPLY

After lagging significantly behind last year's pace for much of 2023, municipal market issuance picked up in the fourth quarter. New issuance supply totaled $99.8 billion in the quarter, bringing year-to-date issuance to $380.5 billion, just a 2.6% decline over the prior year. Tax-exempt issuance increased 7.4% year-over-year, while year-to-date taxable muni issuance totaled just $32.9 billion, or a 30.1% decline. Texas overtook California's long-standing place as the top state for issuance in 2023. Texas issued $59 billion in debt for the year, a 22.5% increase over 2022.

MUNICIPAL MARKET SUPPLY



Source: SIFMA

OUTLOOK

After starting the quarter with yields moving higher through October, market sentiment shifted sharply in November on softer-than-expected inflation readings (though notably still above target) and a seemingly more dovish Federal Reserve. The bond rally continued through the end of the year, and for the quarter, municipal yields moved lower by 92-119 basis points (bps) across the curve. By the end of the year, Fed funds futures markets were pricing in over six-rate cuts in 2024, with an 85% probability of the first cut taking place in March 2024.

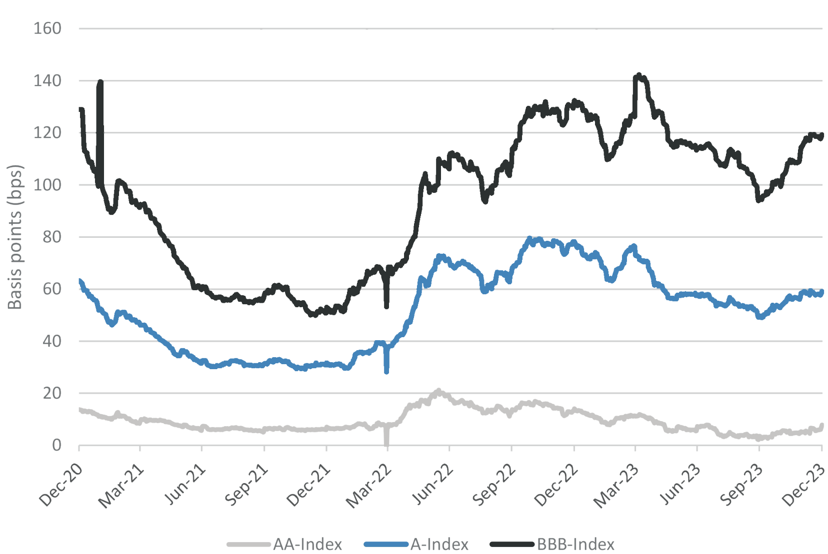
The sharp decline in Treasury yields over the final two months of the year provided a supportive environment for municipals. Tax-exempts outperformed during this period, and as a result, muni / Treasury relative value ratios closed the year near historically tight levels.

Throughout much of 2023, APA actively looked to extend portfolio duration more in line with long-term strategy targets with reinvestment from maturity roll-off and through the execution of beneficial tax-loss swaps to lock in what we believe to be attractive nominal tax-exempt yields on a historical basis. However, with tax-exempt relative value ratios getting stretched to close the year and the market perhaps being overly ambitious on expectations for rate cuts while inflation still runs above target, we are looking to be more selective as we enter 2024. Historically, the second half of December and early January has proven to be a strong period for the municipal market, as new issue supply slows down while robust January maturities and interest payments bring natural reinvestment demand. Simply put, a seasonal supply and demand imbalance known as the "January effect," which can provide a tailwind for tax-exempts.

Ultimately, we expect new issue supply to pick up in 2024, while at the same time, Treasury yields could come under pressure over the near term should the aforementioned expectations for rate cuts in 2024 prove to be overzealous. Thus, we will look to uncover pockets of value in the near term and remain patient as we seek potentially more attractive entry points to extend duration and lock in yield reposition portfolios towards long-term targets.

Finally, we believe the municipal credit profile remains stable. Local government rainy day funds are at historical highs, and market upgrades significantly outpaced downgrades throughout 2023. While that momentum could slow down in 2024, we believe the asset class remains on sound footing, and that defaults will remain isolated to higher risk/sub-investment grade-rated segments of the market. Thus, while APA remains conservative in its approach to credit, we might look to selectively add lower-rated positions (within strategy mandates) with solid underlying metrics that we believe are well-positioned to weather any potential economic slowdown.

CREDIT SPREADS VS. AAA-RATED INDEX



Source: Bloomberg, ICE Data, Bank of America (YTW of AAA, AA, A, BBB-Rated ICE BofA Indices).

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ABOUT APA

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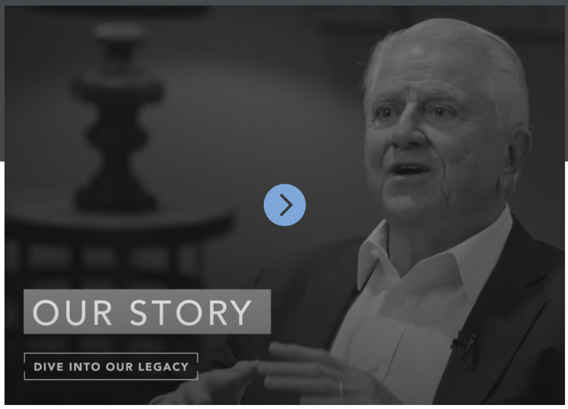
Since its founding, Asset Preservation Advisors is committed to delivering a high level of service, quality and wealth preservation. APA believes our growth in assets under management can be attributed to a consistent investment process and corresponding trading discipline.

We value highly the trust our clients have shown in APA and remain committed to adhering to a high level of ethical, moral and business standards first envisioned at our founding in 1989. Asset Preservation Advisors (APA) is a registered investment advisor founded and specializes in managing high quality, tax-exempt and taxable municipal bond portfolios for other registered investment advisors, family wealth offices and institutional clients.



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