CROSSMARK GLOBAL INVESTMENTS

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MUNICIPAL FIXED INCOME COMMENTARY

Last month, Crossmark highlighted the bond trading desks and the media pushing a shortage of municipal bonds narrative with headlines similar to "Record-breaking Redemption Season Means Historic Cash Flurry." The information from the sources was accurate as to the total number of municipal bonds to be called and matured between June and September, but the current new issues that came to the market during June was greater than anticipated. Historically, June through August is weak for new issues coming to the market and the prices usually move higher for those investors focusing on total return only. In part, municipality and state fiscal years fall in June or July, so it is normal that new issuance will find a slower pace until fresh fiscal budgets are approved. It then takes a short period of time to implement the budgets. This narrative of a redemption bonanza is also based on the 10 year call protection used for most longer term bonds, and 2007 bond issuance in the market was the largest amount prior to the recession cutting into new issuance. In 2016, the 10 year Treasury hit a historical low of 1.42 percent the first week of July before municipalities and states began to take advantage of the low rates by bringing more issues to the market, until the 2016 election results pushed rates much higher. With yields moving lower in June, municipalities and states stepped up the pace of new issuance to begin addressing infrastructure needs across the country. While the argument stands that redemptions will be extra-large when compared to previous years, new issuance could outpace previous years as municipalities are servicing fewer bonds at much lower rate levels, so the capability to address projects is greater. As previously mentioned, patience and selectivity will be key during the summer months.

State and municipality austerity measures will continue into fiscal 2018 as revenue growth is anemic but infrastructure need is growing. Through April 2017, of 35 states reviewed, the average growth of revenue is 1.80 percent, much lower than projected. At some point, maybe in the remaining months of 2017, job growth, low unemployment and the need to hire more quality workers might fuel wage hikes and improve revenue streams for state coffers. If this proves to be the case, then budget expansion to begin addressing infrastructure could dominate FY19 budgets. Fifteen

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- State and municipality austerity measures will continue into fiscal 2018 as revenue growth is anemic but infrastructure need is growing.
- Fifteen states are struggling to finish up next year's budgets as the slow growth in revenues are forcing the municipalities to determine what is needed instead of what is nice-to-have for communities.
- Volatility will continue as unknown structures for tax reform, new issuance projections and bond redemptions are discussed ahead of reality.

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Streets, highways and toll roads have been in the news for years highlighting the need for infrastructure repair, shovel ready jobs, poor road conditions and the general feeling that states and cities are not doing enough, or working fast enough, to keep up with transportation needs. Toll roads have a cycle of revenue growth and usually account for faster repair efforts as the possibility to increase toll costs takes less time and effort than budgeting for a county road. Toll road bonds take a beating when the economy is in recession as fewer drivers pay the tolls. For a positive information cycle for toll roads, one needs to look no further than AAA study of travel growth over the past two years. The study showed that over 39.1 million people traveled more than 50 miles from their homes over Memorial Day. 88.1 percent drove to their destination which is an increase of 2.4 percent over 2016. On an annual basis, total vehicle miles increased 2.2 percent. The largest mileage gains were in North Carolina at 6.4 percent and Michigan at 7.5 percent. This traffic growth has been consistent while at the same time, toll systems have had regular or annual increases. The leverage in additional travel coupled with higher toll fees are allowing toll facilities to improve their infrastructure much faster than a non-toll facility.

Pennsylvania toll rate increases have been occurring annually since 2008, with the most recent increase being 6 percent for fiscal years 2017 through 2020. Even with the higher tolls and regular increases, the Pennsylvania toll usage is up 0.43 percent. Unless the growth in traffic improves to 1.26 percent that is needed for payments and maintain coverage levels, one can expect annual increases to continue. Vehicular travel looks to remain robust as fuels costs are currently low.

Speaking of tax increases, California increased the sales tax on a pack of cigarettes from 87 cents to $2.87 in an attempt to increase revenues for the state. While the revenues increased initially, it was most likely from cigarette users stockpiling ahead of the tax increase. The state has found revenue on cigarettes to be down 64 percent over last year. History continues to repeat as over-taxing a specific area will influence user habits. The cigarette tax windfall California was expecting just became a disappointment.

Municipal bond mutual funds witnessed one of the largest outflows of the year in the last week of June as $891 million was redeemed. Volatility will continue as unknown structures to tax reform, new issuance projections and bond redemptions become discussed ahead of reality. The graph on the following page shows bond yields surging at the end of 2Q17, defiantly against institutional projections. As volatility will continue in the markets, Crossmark will take advantage of trimming where needed when rates are low and adding aggressively, while extending duration when rates spike higher.

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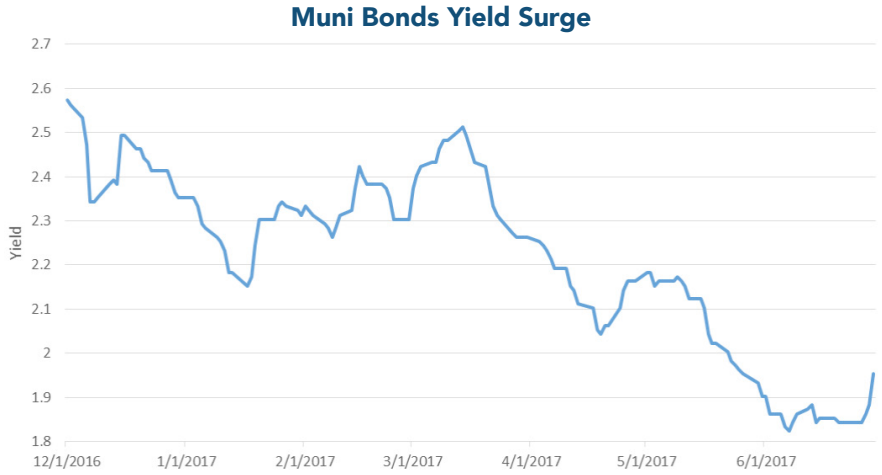
Crossmark Global Investments continues to find value in the municipal secondary market with bonds rated A or better involved with essential services like water, sewer, power, streets, highways, school education and general obligations. The ideal maturities on the yield curve have moved to the 10 to 20 year range with a call feature between 2019 and 2026. Crossmark continues to hold a shorter duration than the Barclay's Quality Municipal Index with a focus on higher quality municipalities. Crossmark Global Investments continues to use municipal bond market volatility to opportunistically manage the portfolios entrusted to us.



Source: Bloomberg

About Crossmark's 30 Year History
Crossmark, previously Capstone Asset Management Company, is an independent investment advisor headquartered in Houston, Texas. Founded in 1987, Crossmark is in its 30th year of providing portfolio solutions for financial advisors and institutional investors with values-based, SRI and ESG values and factor-based strategies. Additionally, Crossmark is the exclusive manager of the Crossmark Steward Funds, which is a fund family that applies an overarching values-based screening methodology to its suite of equity and fixed income funds, including its award-winning Global Equity Income Fund- named Lipper's "Best Global Equity Income Fund" for the last three consecutive years. Crossmark manages approximately $5 billion in assets with clients nationwide.

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