



CROSSMARKGLOBAL.COM

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# MUNICIPAL FIXED INCOME COMMENTARY

In 2008, the Crossmark Global Investments municipal bond team along with the Investment Policy Committee enacted a conservative approach to municipal bond portfolio construction including a vigorous avoid list. Illinois and Puerto Rico were at the top of the list and remain today. Numerous municipal bond mutual funds include Illinois bonds to boost yield. In fairness, there are many Illinois municipalities that are sound financially but are overshadowed by challenged entities including the state itself. Crossmark will settle with a more conservative approach and avoid the entire state for the time being. A chart of the Illinois pension liability is included in this commentary. Since a picture is worth a thousand words, the chart speaks volumes to why Illinois was placed, and remains today, on the Crossmark Global Investments municipal bond avoid list.

The summer doldrums have hit again and investors query why municipal bond prices don't seem to move in sync with the Treasury market. One of many possible answers is the fact that \$44.7 billion in municipal bonds will be called in July with only \$3.2 billion in visible supply to be issued. This is not unusual for the summer months to see more bonds called or matured than what is offered to the public in new sales. Higher new issue volume historically occur in October, November, January, February and April.

According to the U.S. Census Bureau and Bureau of Economic Analysis, state and local government tax collections increased in the most recent quarter and future collections may go higher, thanks both to the growing economy and to the Supreme Court's Wayfair decision that opens the way for states to collect sales tax on all internet purchases made from out-of-state sellers. 1Q18 total state and local tax collections increased by 6 percent over the same quarter last year. The ability to expand sales tax collections could mean an additional \$184 to \$291 million in annual tax revenue per state, on average, according to a study by the GAO (General Accounting Office). Total state and local tax collections (which include property, income, gasoline, motor vehicle, alcohol, tobacco and sales taxes) increased by 6.4% in 1Q over the first quarter of last year. That is a strong improvement since the year before, as 1Q17 was up 3.3% versus 1Q16. For the year, 2017 collections were up 4.6% versus 2016.

September 2018 could be an interesting month for fixed income volatility. The FOMC has communicated a short-term Federal Funds rate hike in September, anticipated to be 25 basis points, as well as beginning the run off of the Federal bond portfolio balance sheet. This is where it could get sticky as information should increase in the days and weeks prior to the FOMC normalization plan. The current plan is to allow the balance sheet to run off as bonds mature with a ceiling that would allow reinvestment of

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Mortgage Backed Securities that exceed the ceiling level. With interest rates moving gradually higher, there have been fewer MBS bonds being paid off so the amount returning to the balance sheet is below the ceiling. This means several outcomes that could contribute to volatility. Fewer bonds qualifying for reinvestment means the balance sheet could run off faster than previously anticipated. The flip side of this is that less money may be coming off the balance sheet than anticipated. Consider the amount to roll off may be less than projected but the reinvestment above

the ceiling level on MBS bonds appear to be zero at this time. Zero bonds reinvested means the balance sheet may shrink faster than anticipated. Shrinking the balance sheet is essentially tightening. Confusing? Absolutely. Wait until the media begins to inject speculation to the equation.

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 7 to 15 year range with a call feature between 2019 and 2024. Crossmark Global Investments 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.

#### About Crossmark's 30 Year History

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For more information contact our Advisor Solutions Group:  
advisorsolutions@crossmarkglobal.com  
888-845-6910

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