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September 30, 2017

MUNICIPAL FIXED INCOME COMMENTARY

Crossmark recognizes the tragic events that have taken place this quarter. Lost lives are a painful reminder of the natural disasters and unnatural events that have taken place. This truly has been a difficult quarter in terms of personal impact to lives, property and infrastructure. As we mentioned last month, Hurricanes Harvey, Irma, Katia and Maria as well as numerous wildfires in the west and northwest are events that have yet to unnerve the municipal bond market. Government aid, increased interest rates, and a quick recovery will keep municipalities and other borrowers from default. To date, not a single municipal borrower that was rated by Moody's has defaulted due to a natural disaster. State and Federal aid will be used heavily to help affected areas to rebuild.

Puerto Rico is in crisis. Prior to Hurricane Maria, Puerto Rico was already in default and challenged on so many fronts that it didn't appear there was much hope for municipal bondholders to receive more than an estimated 65 to 85 percent of face value. Then, Hurricane Maria devastated the island. The possibility of repayment levels on the Puerto Rico bonds has now dropped to an estimated 35 to 65 percent of face value. Puerto Rico owes $72 billion in debt, has seen a population reduction since 2007, high unemployment, declining revenues, questionable government oversight, lost access to financial markets, become entangled in legal battles, and now Hurricane Maria has taken a vast majority of the infrastructure to unusable status.

Is Puerto Rico at rock bottom? Probably not. Given current conditions, one can expect a sizable population exodus from the island to the United States. The Governor of Puerto Rico suggests that the exodus to the states will not be measured in the hundreds of thousands but rather by the millions of people.

History shows that population declines in given areas pose fiscal challenges in the future. Detroit is a prime example as they experienced a gradual population reduction that began in the late 1960's that eventually contributed to bankruptcy. Population reduction is not a sole cause of financial difficulty to a state or municipality but is incredibly troublesome for revenue generation. Increased taxation to offset population reduction usually forces more people to relocate. The reduction in Puerto Rico population base since 2007 is problematic but this latest natural disaster will entice so many people to leave that current government continuity may be challenged.

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- A month later and reports are beginning to surface from credit agencies in regards to Houston. One report from Standard & Poor's stated "The long-term impact appears minimal.
- The 3Q17 witnessed a sizable swing in the 10 year Treasury.
- As August came to a close and September ushered in a higher interest rate, inventory selection improved as purchases reduced cash levels at more reasonable pricing that resembled drought stricken steers sold at auction.
- With the Federal Open Market Committee displaying hawkish dialog, dialing back on the Federal bond portfolio by allowing select sectors to mature without reinvestment and the possibility of a new FOMC chairperson appointed, there could be higher interest rates by the end of the calendar year.

Prior to Hurricane Maria, our Municipal Bond Portfolio Manager suggested that Puerto Rico could vote for statehood in 2018 with Congress addressing the vote in future Congressional sessions. With the island infrastructure in dire conditions, there will be more attention that must be directed towards Puerto Rico. Federal assistance will occur, but will be far short of repairing the island to prior status, which was minimally efficient at best. In the end, Puerto Rico will probably vote for statehood, by the reduced population left behind, possibly in last grasp hopes for an improvement to their living conditions.

Crossmark has never purchased Puerto Rico bonds and has consistently suggested refrain from speculating a bottom for pricing. It remains an avoid situation as we hope for the best for the recovery of Puerto Rico.

Municipal bond investors must beware of looking through media optics. Images of people stranded on rooftops and being evacuated by flat bottomed boats are emotional and magnified through the optics of the media. Numerous reports about Houston municipalities following Hurricane Harvey, where the Crossmark's home office is located, ranged from placing municipal utility districts under negative watch to potential downgrades of flood ravaged locations. When an area receives extraordinary levels of rainfall, flooding becomes historic which elevates the media exposure. While Florida areas got 8 plus inches of rain with Maria, it was a brutal reminder of weather forces. Just imagine what Hurricane Harvey delivered over a five-day period to the Houston area. Some outer lying areas got 30 plus inches but a special location southeast of Houston recorded 51.88 inches of rain. The media focused on the devastation. One month later, reports are beginning to surface from credit agencies in regards to Houston. One report from Standard & Poor's stated "The long-term impact appears minimal. Most local governments will be unaffected." The words that stand out in these reports from credit agencies are "minimal", "temporary" and "marginal." Insurance and FEMA action will lessen the effects of this current hurricane to the level that there will be short to intermediate term challenges but little to the long term health of a growing population base. While some media suggested that lower revenue from the disaster could occur, there are some levels of revenue that improved. How does that happen when there is a disaster? The answer in this particular situation is that hotel occupancy rose as displaced individuals had to go somewhere in the short term and FEMA workers and others responding to the storm descended onto the Houston scene. Occupancy in Houston hotels rose to 87 percent as compared to a year earlier at 59 percent based on a 30 day average ending September 30. The average room rate increased by 12 percent to $116 per night. This resulted in a 116 percent increase in revenue per available room.

The 3Q17 witnessed a sizable swing in the 10 year Treasury. The move from the previous quarter saw the 10 year Treasury decline to roughly the 2.00 percent level then swing back towards 2.34 percent to end September. During this period, Crossmark took advantage of higher pricing in July and August by liquidating credits that have experienced several downgrades over the years such as select New Jersey, Connecticut and Rhode Island credits. The state of New Jersey has experienced 5 credit downgrades since 2010. Connecticut and Rhode Island are experiencing population and business

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base declines. The cash levels increased in the Crossmark municipal bond portfolios as inventory was subject at best and pricey like an award winning state fair heifer. These levels assisted our selective selling for the client benefit. As August came to a close and September ushered in a higher interest rate, inventory selection improved as purchases reduced cash levels at more reasonable pricing that resembled drought stricken steers sold at auction. Depending on interest rate levels, portfolios will see duration increase slightly as it is anticipated volatility will continue through year end. Crossmark municipal bond portfolios have been constructed years prior to take advantage of higher interest rates with a lower risk factor than the benchmark index. With the Federal Open Market Committee displaying hawkish dialog, dialing back on the Federal bond portfolio by allowing select sectors to mature without reinvestment and the possibility of a new FOMC chairperson appointed, there could be higher interest rates by the end of the calendar year.

Crossmark 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 continues to use municipal bond market volatility to opportunistically manage the portfolios entrusted to us.

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 has a multi-decade legacy 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 Steward Global Equity Income Fund- named Lipper's "Best Global Equity Income Fund" for the last three consecutive years.

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