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MUNICIPAL FIXED INCOME COMMENTARY

There's been twelve consecutive weeks of selling in municipal bond mutual funds. The final week of the year brought mixed results with net buying in long maturities and high yield while intermediate term investment grade endured net selling. Technically, intermediate municipal bond funds recorded thirteen consecutive weeks of selling. Interestingly, the Treasury market staged a rally of epic proportions in December primarily aided from domestic and global equity volatility. Staggering to see the yields bounce all over the spectrum during 2018 as the Federal Open Market Committee (FOMC) remained steady with four 25 basis point increases to short-term Federal Fund Rates. The ten year Treasury saw yields beginning around 2.43 percent then change to above 3.20 percent in the first quarter, to below 2.70 percent during the summer, another run above 3.24 percent in October/November then down to finish the year around 2.69 percent. That is more volatility than witnessed in the fixed income markets for many years and one can expect 2019 to usher in similar possibilities. Investors will probably reverse the course of liquidating municipal bonds to being net buyers.

There will likely be a January Effect in 2019 as fewer municipal bonds will be issued than what will mature, be called, and interest paid to investors. In short form definition, there will be "more buyers than sellers" and that will potentially drive pricing higher in the short-term to begin 2019. An influence to the dropping yields, including the equity market volatility to the downside in December as well as the Fed Fund futures posting a less than 15 percent chance of a rate hike in 2019 seems to have pushed municipal bond buyers to the sideline for the time being. Interesting that in 4Q18, everyone was convinced, and supported by FOMC guidance, there would be four interest rate hikes in 2019 and two rate hikes in 2020. It is interesting how a short period of time can change perception of anticipating two rate hikes to a current discussion of zero rate hikes going forward. In fact, some discussion has been centered as to when and how soon the FOMC will be dropping short-term Fed Fund rates. In 2018 when the FOMC was giving guidance of four rate hikes in 2019 and two in 2020, the Crossmark Global Investments Senior Portfolio Manager for Municipal Fixed Income speculated that the guidance might be aggressive and publically suggested two rate hikes in 2019 and possibly zero in 2020. Fast forward to the end of 2018 and some financial writers are producing articles outlining why there will be zero short-term Fed Fund rate hikes in 2019 and possible cuts due to deteriorating economic fundamentals. FOMC guidance sounds logical for 2019 which could produce more pronounced volatility in pricing especially as we approach each FOMC meeting. Should the FOMC include one or two rate hikes in 2019, the market could adjust in a violent fashion. Crossmark Global Investments is anticipating

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The December FOMC meeting was about as dovish as possible, although the equity market might have interpreted the message as hawkish, driving equity values lower. FOMC signaled very clearly that if financial conditions deteriorate nationally or globally then they might not raise rates in 2019. However, FOMC base case at year end was to raise rates twice in 2019 and once in 2020 regardless of various factors, including but not limited to, Trump tweets at wee hours of the morning. There is also a media concern of the Quantitative Tightening and how this might increase the yields on the long end of the curve. At this time, there is no evidence Quantitative Tightening is having an effect, probably because it will take a substantial period of time to organically allow maturities to occur instead of actual selling of portions of the portfolio in the open market. At the end of each quarter going forward, the FOMC will perform their dot-plots and be tight fisted with information in order to not get backed into a corner and be forced to change course to their message and guidance. Therefore, it should have been unrealistic to expect the FOMC to signal the end of the current tightening cycle. Everyone wants immediate gratification but be aware that one may not get it on their predetermined time schedule.

To round out the year end commentary on a positive note, states collected more than $1 Trillion in tax revenue in fiscal 2018, which is a record, according to a report by the Tax Policy Center. The total increased by 4.8 percent from 2017. It is anticipated the states will refrain from immediately spending this windfall increase. Some will be placed in underfunded pensions and infrastructure investments, but don't be surprised if most of this is carried over for a rainy day.

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 2020 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.

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