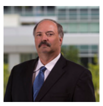
Municipal Fixed Income

Commentary | Quarterly update: 1Q25

Separately managed account



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Markets and performance

Municipal bonds experienced negative volatility to end 1Q25. Investment grade municipal yields moved higher from March across all maturities as tariff announcements began April 2 and FOMC hinted that rates cuts may slow in 2025. Separately managed accounts (SMAs), exchange-traded funds (ETFs), funds, and money manager flows are splitting investments between the short end and the intermediate curve for attractive yield and extending duration heading into 2Q25. The narrative of possible Fed funds short-term rate cuts for 2025 has shifted to potentially one or two by year-end, depending on economic data.

Positive and negative contributors to performance

The Crossmark Municipal Fixed Income composite portfolio posted a loss of -0.53% for the quarter versus a gain of 0.6391% for the Bloomberg Quality Intermediate Municipal Index. Investing in high-quality credit of essential service revenue and general obligation bonds with a premium coupon underperformed the benchmark index. BBB credit, as well as lower coupon and housing, healthcare, assisted living, and retirement centers, held up better than higher quality in 1Q25. Airports, transportation, and essential services such as water, sewer, and utility sectors performed well. March was very volatile for pricing.

Looking ahead

New issuance for 2025 is estimated to be another record of $550 billion or more, which could again exceed the amount of bonds that mature and are to be called. That may also place negative price pressure on the municipal bond market relative to other fixed income sectors until seasonal adjustments begin in June. Municipal bonds appear to be approaching an oversold scenario at quarter-end. It is possible that yields continue a move higher now that the FOMC suggested rate cuts in this cycle may slow as well as unknown activity once tariff trade wars develop. This volatility could continue to be an opportunity to establish or add to municipal bond SMAs this year.

The yield curve could steepen, then normalize, as the rate cycle matures, with up to two potential rate cuts before year-end. For those uncertain about the yield-curve normalization, longer duration with a 5–7-year bond call feature appears most advantageous.

Holding cash—or market timing the fixed income yields—may not be the best strategy, as cash positions historically underperformed during Fed easing cycles. Opportunistically extending duration going forward may be a more favorable option than market timing.

Crossmark continues to find value in the primary and secondary municipal market with bonds rated A or better by Moody's, Standard & Poors, or Fitch at the time of purchase and involved with essential services like water, sewer, power, streets, highways, public education, and general obligations. Our strategy focuses on maturities in the 12- to 20-year range with call features between late 2029 and 2035. The municipal bond yield curve has increased in the five- to 20-year maturities, making these call features an ideal area to focus on during volatile periods. The strategy will use longer-duration positioning than the benchmark index on reinvestments as the FOMC continues its battle with inflation, focusing on higher-quality municipalities with a goal to move duration longer as the interest rate curve normalizes.

Composite performance (%)	Quarter	YTD	1-year	3-year	5-year	10-year	Since inception
Municipal Fixed Income (Wrap) – Gross	-0.53	-0.53	0.85	1.62	1.00	1.42	3.16
Municipal Fixed Income (Wrap) – Net[1]	-1.27	-1.27	-2.09	-1.38	-1.99	-1.59	0.11
Bloomberg Quality Intermediate Municipal Index	0.64	0.64	1.74	1.94	1.14	1.79	3.43

1 Net performance was calculated using the hypothetical highest annual all-inclusive wrap fee of 3.00%, with a deduction of 0.25% from each month's return. Gross performance is shown as supplemental information and represents pure gross returns, as they have not been reduced by transaction costs or fees. Wrap fees include Crossmark's portfolio management fee, trading costs, custody, and other administrative fees. Due to the effect of compounding, annual returns shown net of fees may be lower than the return that would be shown if the fee were deducted from the gross return at a single point in time.

Crossmark uses a model account to manage the individual client accounts that have selected this investment strategy. All performance information shown is composite performance derived from the aggregate of all accounts included in the composite.

Our firm

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All Investments are subject to risks, including the possible loss of principal. Past performance does not guarantee future results. The Municipal Fixed Income strategy may not achieve its objective if the managers' expectations regarding particular securities or markets are not met. Fixed income investments generally involve three principal risks—interest rate risk, credit risk, and liquidity risk. Prices of fixed-income securities rise and fall in response to interest rate changes (interest rate risk). Generally, when interest rates rise, prices of fixed-income securities fall. The longer the duration of the security, the more sensitive the security is to this risk. There is also a risk that the issuer of a note or bond will be unable to pay agreed interest payments and may be unable to repay the principal upon maturity (credit risk). Lower-rated bonds, and bonds with longer final maturities, generally have higher credit risks. As interest rates rise and/or the credit risk associated with a particular issuer changes, bonds held within a portfolio may become difficult to liquidate without realizing a loss (liquidity risk). Many municipal bonds also include call features that allow the issuer to call the bonds—repaying the principal before maturity—usually done in the context of a refinancing transaction if/when interest rates fall. When a bond is called, the holder does not incur a loss, but cash received from the call must be re-deployed, generally in a less favorable interest rate environment (call risk).

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Crossmark claims compliance with the Global Investment Performance Standards (GIPS®). Prospective clients can obtain a GIPS Composite Report by sending a request to: advisorsolutions@crossmarkglobal.com.

The U.S. Dollar is the currency used to express performance. The performance reflects the reinvestment of dividends and other earnings to the extent that client accounts included in the composite elected to reinvest dividends and earnings. Performance figures shown gross of fees do not reflect the payment of investment advisory fees.

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