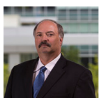
MUNICIPAL FIXED INCOME
COMMENTARY 2Q 2020

Municipal Fixed Income is a separately managed account investment strategy



written by
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Crossmark's Municipal Fixed Income SMA strategy was a net buyer of high-quality essential service revenue and general obligation municipal bonds during the second quarter of 2020. The disconnect between municipal bonds and other sectors of fixed income, mainly Treasuries, was so pronounced that institutions, insurance companies, community banks, regional banks, foreign buyers, and cross-over buyers refocused on the benefit of owning municipal bonds. The strategy took full advantage of the opportunity to extend duration while maintaining high-quality bonds, focused on essential services and general obligations.

States and local municipalities took swift action to cut services, curtailed hiring, and furloughed or terminated workers to offset disrupted revenues due to the COVID-19 pandemic. The pace of action by municipalities was swifter than witnessed during the 2008 recession, as municipalities attempted to get ahead of any revenue interruptions. Until there is a more scientific approach to reducing the spread of COVID-19, it may be too early to determine the extent of damage to municipality or sector revenue. Several sectors were negatively impacted more than others, such as transportation. Transportation quickly became the poster child for a negative watch of potential downgrades by the credit rating agencies. Transportation is a mixed bag, but the immediate media response had investors believing all transportation was equal. Transportation revenue was negatively impacted, especially in densely populated areas where subway, rail, and bus are the transportation method of choice. Airports and tollways also felt the impact of the virus as fewer people traveled or even left their homes. However, we believe that transportation costs will rise in the future after fuel savings are exhausted.

Not all transportation is equal nor a municipal entity. Most large airports, being a municipality, are being lumped together with airlines, a corporate entity. Airports do need airlines to fly, but the revenue stream is different in several ways. Airlines have a different revenue path that requires paying customers to purchase tickets for a seat to a given destination. Airlines have lease agreements with airports that must be satisfied, regardless of the airline activity. Airlines pay a landing and takeoff fee, and fuel purchased has a partially paid tax to an airport. Airlines may not have full seats, but it still has to purchase fuel and pay ramp and fuel fees. Many of the larger airport municipalities have cash on hand to weather a period for debt coverage, assuming no additional revenue is established. This is not a complete list of variables by the transportation sector but discussion points that should be evaluated by an individual municipal entity rather than by sector.

We believe there will be credit rating downgrades for municipalities across the country. The riskiest municipalities, which may include, but not limited to, hospital, healthcare, retirement centers, assisted living, hotels, convention facilities, housing, jails, and prisons, are currently under review to determine the possible change in credit rating. High-yield municipal bonds, those with credit ratings below investment grade, have performed well as investors have increased flows into those riskier investments to make up for falling interest rates in their previously held, lower-risk investments. As the breadth of damage to the economy and municipalities becomes more evident, riskier assets such as high-yield municipal bonds that have performed well recently, may come under pressure due to a reallocation process. We believe the best protection for tax-exempt income is to remain invested in high-quality essential service and general obligation municipal bonds. Municipal bonds continue to be one of the safest fixed-income investments, second only to US Treasuries. However, municipal bonds currently produce a higher percentage of income when compared to US Treasury bonds.

We continue to find value in the municipal secondary market with bonds rated A or better by Moody's or Standard & Poors (at time of purchase), involved with essential services like water, sewer, power, streets, highways, school education, and general obligations. The yield curve's ideal maturities have moved to the 8 to 20-year range with a call feature between 2023 and 2027. The strategy limits maturities to 20 years. We continue to hold a shorter duration than the Barclay's Quality Intermediate Municipal Index, with a focus on higher-quality municipalities. We are also continuing to use municipal bond market volatility as an opportunistic play to manage the portfolios entrusted to us.

Our Firm

Crossmark Global Investments is a boutique investment management firm that provides a full suite of investment strategies to institutional investors, financial advisors, and the clients they serve. For over 30 years we have delivered uniquely-constructed products based on our proprietary, disciplined, and repeatable process. We are especially known for helping our clients align their investments with their values by creating socially-conscious, responsible investment strategies. Founded in 1987, we are headquartered in Houston, Texas.

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