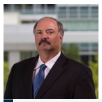
QUARTERLY UPDATE: 2Q 2022

MUNICIPAL FIXED INCOME COMMENTARY

Separately Managed Account



written by
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Markets and Performance

Municipal bonds have experienced the worst start to a year since 1980 as the highest inflation in 40 years has caused dramatic swings in volatility. Municipal bond mutual funds have witnessed net outflows for eighteen of the last nineteen weeks totaling over $83 billion, according to Bloomberg indexes. Bids from municipal bond mutual funds (the equivalent of an auctioneer requesting the best price for a bond from a large audience) surged 50 percent to a daily average of $1.56 billion on fund outflows in the second quarter. According to ICI data, this is an increase of 250 percent over the first quarter. The municipal bond index posted a loss of 9.64% year-to-date.

Positive and Negative Contributors to Performance

The Crossmark Municipal Fixed Income model portfolio posted a loss of 0.62% for the quarter ending June 30, versus a loss of -0.926% for the Bloomberg Quality Intermediate Municipal Index. Investing in high-quality credit with a premium coupon positively contributed to the model portfolio's performance. Lower coupon bonds in the index declined more than premium coupon bonds held in the model, as municipal bond rates were volatile within a trading range during the quarter. The shorter duration positioning of the Strategy was also a positive contributor to performance versus the index last quarter as the Federal Reserve delivered a 75-basis point rate increase in an attempt to slow high inflation. The shorter duration of the municipal bond market was heavily preferred during the second quarter as investors took a wait-and-see approach to the Fed tightening cycle in its battle with inflation.

Looking Ahead

Volatility in municipal bonds has created an oversold sector. This could be an opportunity to acquire municipal bonds at favorable levels for separately managed accounts and patient investors. July and August are the second and third largest months of the year for redemptions from matured, pre-refunded called bonds and interest. July will post $41.5 billion, and August will be just shy of $40 billion redeemed, possibly creating a buyer-heavy tone. The offset could be the Federal Reserve and how they react to current inflation numbers in the quarter. A segment to watch in the overall picture of inflation is wages. Wages are sticky; once they tick higher, they generally don't come back down for an extended period. The July expiration of contracts for the International Longshore and Warehouse Union and more than 70 employers represented by the Pacific Maritime Association (covering dockworkers across 29 ports in California, Oregon, and Washington) is a risk for strikes, lockouts, or work stoppages. Meanwhile, major railroad labor unions have unsuccessfully negotiated contracts for two years. Trucking at the ports has been inconsistent – productivity has eroded, with container warehouse storage vacancy at just 0.30%, yet workers are feeling the pinch from inflation at 40-year highs and past anemic wage increases. If there are work stoppages, it could lead to more supply chain issues (supporting inflation). If wages are negotiated higher, this will also support higher inflation. This uncertainty by itself could increase yield volatility in the third quarter.

Looking Ahead (continued)

Crossmark continues to find value in the secondary municipal market with bonds rated A or better by Moody's, Standard & Poor's, or Fitch at the time of purchase. We seek bonds involved with essential services like water, sewer, power, streets, highways, public education, and general obligations. Our Strategy focuses on maturities in the seven to twenty-year range with call features between 2025 and 2029. The municipal bond yield curve has steepened in three to seven-year maturities, making these calls an ideal area of focus during volatile periods. The Strategy will continue to utilize shorter duration positioning than the benchmark index as the Federal Reserve continues its rate hike battle with inflation. We will focus on higher-quality municipalities to move duration longer as the interest rate curve normalizes.

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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