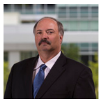
CROSSMARK
GLOBAL INVESTMENTS

MUNICIPAL FIXED INCOME
COMMENTARY | QUARTERLY UPDATE: 3Q 2022

Separately Managed Account



written by
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Markets and Performance

Municipal bonds have experienced the worst September since February 1980 as the worst inflation in 40 years brings wide swings and volatility. For the quarter, most of July and August were positive but September negative returns were intense. Municipal bond mutual funds have witnessed net outflows totaling over $102.3 billion, according to Bloomberg indexes. The Bloomberg Barclay's Quality Intermediate Municipal index posted a loss of -8.29% YTD. The year to date municipal bond total return is worse than any full year in the ICE municipal index in the 34-year history of the index.

Positive and Negative Contributors to Performance

The Crossmark Municipal Fixed Income model portfolio posted a loss of -1.14% for the quarter ending September 30 versus a loss of -2.44% for the Bloomberg Quality Intermediate Municipal Index. Investing in high-quality credit with a premium coupon positively contributed to the model portfolio's performance as lower coupon bonds in the index declined more than premium coupon bonds held in the model as municipal bond rates were volatile during 3Q22. 3.00% coupon bonds underperformed 5.00% coupon bonds by more than 350 basis points. The shorter duration positioning of the Strategy was also a positive contributor to performance versus the index in 3Q22 as the FOMC delivered 150-basis point rate increases in an attempt to slow stubbornly high inflation. Shorter duration of the municipal bond market was heavily preferred during 3Q22.

Looking Ahead

Municipal bond volatility, primarily from municipal bond mutual funds liquidating large positions has created an oversold sector and could continue to be an opportunity to acquire municipal bonds at favorable levels for Separately Managed Accounts (SMA) and patient investors. Bids wanted for bonds greater than $1,000,000 in size is ranging between 350 to 900 lots per totaling $1.2 billion to $2.9 billion daily with 55% to 70% actually trading. This activity is providing high quality inventory at reasonable pricing to build portfolios. October through December months of the year are mild to moderate for the redemption from matured, pre-refunded, called bonds and interest. October will post $35.3 Billion creating a possible buyer heavy tone early in the month but could fade quickly with so much liquidity available in municipal bond inventory. Last quarter, we suggested watching the overall picture of inflation resulting from wages. Once wages go higher, it generally doesn't come back down for an extended period creating sticky inflation. Contracts for the International Longshore and Warehouse Union and the more than 70 employers represented by the Pacific Maritime Association covering dockworkers across 29 ports in California, Oregon and Washington risks opportunities to strikes, lockouts or work stoppages as the deadline to negotiate a contract expired in July. Meanwhile, major railroad labor unions have successfully negotiated a contract that include a 24 percent wage increase over five-year period between 2020 and 2024, including an immediate 14.1 percent wage increase, $1000 per year for five years of annual payments to pension as well as additional time off for health and personal time. If other wage contracts are negotiated higher then inflation could take another step higher.

Crossmark continues to find value in the 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 seven to twenty-year range with call features between 2027 and 2034. The municipal bond yield curve has increased in the five to twelve-year maturities making these call features an ideal area to focus on during volatile periods. The Strategy will continue to utilize shorter duration positioning than the benchmark index as the FOMC continues their rate hike battle with inflation, focusing on higher-quality municipalities with a goal 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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