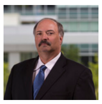
Municipal Fixed Income

Commentary | Quarterly Update: 4Q 2023

Separately managed account



Patrick Garboden, Sr. Portfolio Manager

Markets and performance

Municipal bonds experienced violent negative volatility to end 4Q23 as investment grade municipal yields moved lower from October peak across all maturities. 5-year through 20-year final maturities moved significantly lower in yields to finish 2023. Separately managed accounts, ETFs, funds and money manager flows continue to focus on the short end of the curve for attractive yield and a short-term defensive position in October. When the FOMC verbiage of holding rates “higher for longer” became overshadowed with talk of a pause, investors poured into longer maturities in hopes of rate cuts to begin 2024.

Positive and negative contributors to performance

The Crossmark Municipal Fixed Income composite posted a gain of 6.07% for the quarter and 4.48% for the calendar year ending Dec. 31, 2023 versus a gain of 5.86% for the Bloomberg Quality Intermediate Municipal Index for the quarter and 4.65% for the calendar year. The strategy underperformed the benchmark due to investing in high-quality credit of essential service revenue and general obligation bonds with a premium coupon. For the period, the hospital/healthcare sector, the BBB credit sector and lower coupons from zero to 3.75%, all of which the strategy currently avoids, outperformed the general municipal market, ahead of the strategy’s composite. We will continue to focus on the higher quality-rated and premium municipal bonds as a conservative hedge against potential declines in the economy in the future.

Looking ahead

Municipal bond volatility should continue to be an opportunity for income and total return for separately managed accounts (SMA) in 2024, primarily from municipal bond mutual funds net inflow as investors focus on potential future rate cuts. Based on CreditSights’ preliminary supply and redemption data, net supply in 2024 may increase to $121 billion, with potential price pressure in 1Q24. If the FOMC pauses to track the effectiveness of their hike cycle actions, the yield curve should begin to flatten out, then normalize, as the rate cycle matures in 2024. Regardless of future FOMC decisions and economic data, municipal bond yields are better than what we have seen in over a decade, resulting in a great period to reassess asset allocation to fixed income.

Crossmark continues to find value in the primary and secondary municipal market with bonds rated A or better by Moody’s, Standard & Poor’s, 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 2029 and 2034. The municipal bond yield curve has increased in the five to 12-year maturities, making these call features an ideal area to focus on during volatile periods. The strategy will utilize longer duration positioning than the benchmark index on reinvestments as the FOMC continues their battle with inflation, focusing on higher-quality municipalities with a goal to move duration longer as the interest rate curve normalizes.

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.

Composite performance (%)	QTD	YTD	1-year	3-year	5-year	10-year
Municipal Fixed Income (Wrap) – Gross	6.07	4.48	4.48	0.57	1.59	1.73
Municipal Fixed Income (Wrap) – Net[1]	5.29	1.40	1.40	-2.42	-1.42	-1.29
Bloomberg Quality Intermediate Municipal Index	5.86	4.65	4.65	-0.14	1.98	2.27

1 Net performance was calculated using the hypothetical highest annual all-inclusive wrap fee of 3.00% by deducting 0.75% from the last month of each quarter. Gross performance is shown as supplemental information and is stated as pure gross of all fees as the returns have not been reduced by transaction costs. Wrap fees include Crossmark's portfolio management fee as well as all charges for 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.

Our firm

Crossmark Global Investments is a faith-based firm that creates and manages values-based investment strategies for financial intermediaries and their clients. Founded over 35 years ago, the firm has a rich history of inspiring and equipping its clients to go further in aligning their investments with their values. Crossmark is based in Houston, Texas. For more information, visit crossmarkglobal.com.

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