RIVERBEND Capital Advisors

Municipal Comment

March 2021

Adjusting Course

Despite the upward trend of yields in the US Treasury market since the beginning of 2021, municipal bond yields only began to catch up in late February, at which time they spiked quickly and by nearly 50 basis points on the long end. Previously rich ratios to UST's and corporate bonds rapidly recalibrated to fair value. Municipal bond mutual funds experienced the first outflows in four months. In sum, it was a long-awaited and much needed reset as measured by various market metrics, resulting in more appealing yields and relative value.

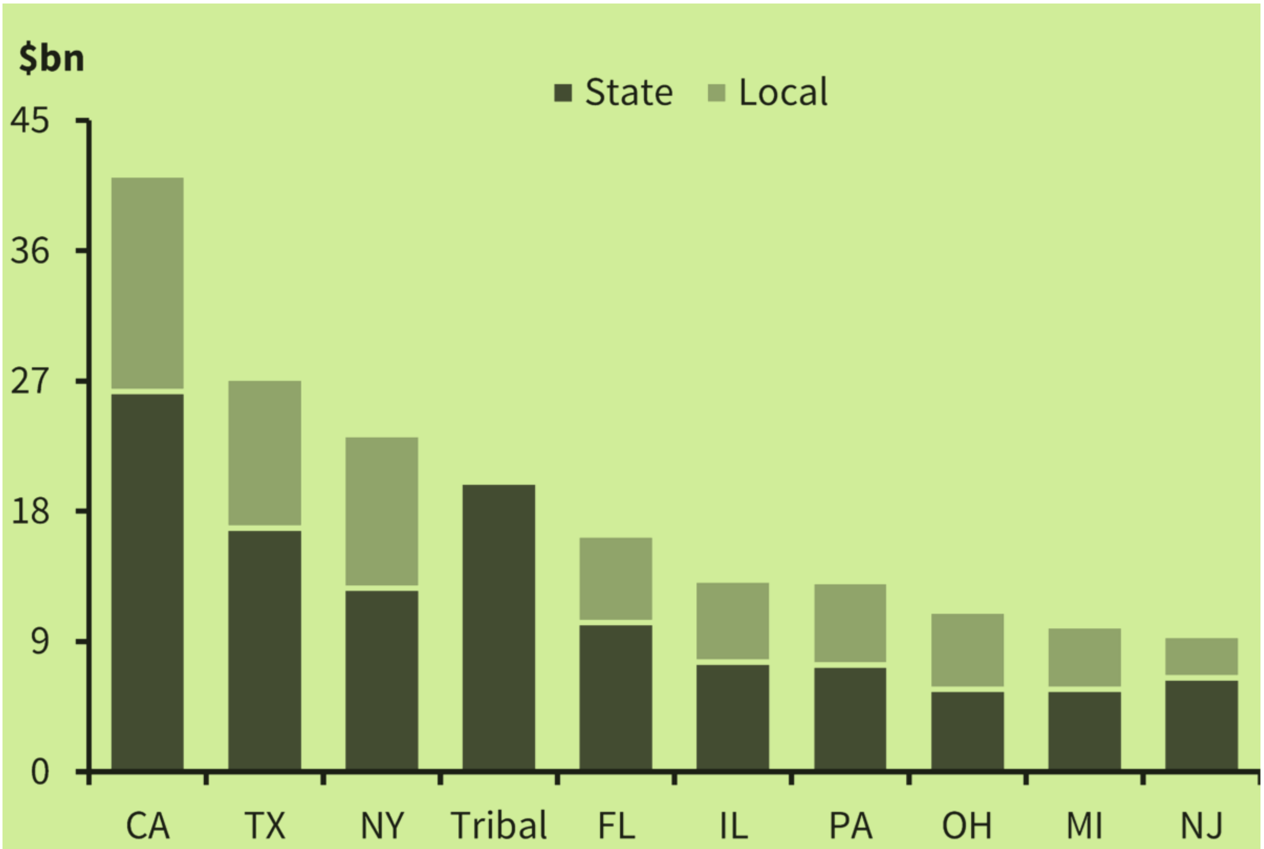
Opportunities could present themselves if munis face additional pressure in the coming weeks and typical seasonal trends play out. At this time of year, several recurring circumstances often contribute to market underperformance. Investors redeem bond mutual funds to raise cash for income tax payments, leading to selling pressure. New issue supply becomes heavier as states and municipalities price more deals. The volume of March and April maturities and coupon payments is lesser than other times of the year, so there are fewer proceeds to be reinvested in munis. These trends coupled with a continuation of the Treasury market slide are likely to result in increased volatility. However, given tailwinds that will benefit the muni asset class in the intermediate and longer term, it may be beneficial to take advantage.

Federal Deluge

We can be quite confident that the recent muni market selloff was not driven by credit concerns. Passage of the $1.9 trillion American Rescue Plan (ARP) ensures that many municipal sectors will receive substantial direct and indirect support. Consider $350 for state and local government aid, $170 billion for schools. While the plan has provisions that limit the use of funds for such actions as plugging pension shortfalls and cutting taxes, the enforcement of these restrictions will be difficult and seems unlikely.

The ARP assistance is arriving even as state and local tax collections continue to improve. Before the ARP, many states were already experiencing better than expected tax receipts. On average, 2020 state tax revenues were essentially unchanged year-over-year due in part to stable income and capital gains tax collections. Local governments benefitted from the strong real estate market and steady property tax receipts. The massive, imminent wave of direct ARP assistance will be a credit positive for state and local governments, school districts, hospitals, airports, and mass transit. Additionally, ARP provides significant aid to individuals and businesses which will also benefit muni issuers through consumption taxes and other indirect means.

Top Ten American Rescue Plan Funding Recipients



U.S. Department of Housing and Urban Development

Rating agency upgrades are already underway in anticipation of the sizable infusion of federal funds. Moody's revised its sector outlook for local governments to stable from negative due to improving financial and economic conditions.

In the "rising tide lifts all boats" department, Chicago Board of Education has already been upgraded by Moody's to Ba3 from B1 and Standard and Poor's has changed BBB- rated Illinois GO outlook to from negative to stable. Both credits will reap substantial benefit from the ARP.

The Future Looks Bright

While the market may experience some degree of volatility due to supply pressure, tax-related seasonal fund redemptions and UST rates moving higher, many trends favor munis for the longer term:

- Positive credit fundamentals will be strengthened by direct state and local assistance from the American Rescue Plan and will also benefit from the general economic stimulus the ARP provides.

- Anticipated increases in tax rates for high wage-earning individuals will drive demand for tax-exempt income.

- The Tax Cuts and Jobs Act of 2017 cut the corporate tax rate from 35 % to 21%, resulting in diminished muni buying by banks and insurance companies. A likely full or partial reversal of this tax cut would renew institutional participation.

Muni outperformance is a reasonable expectation as investor demand increases due to a combination of higher yields, cheaper valuations, improving credit fundamentals and federal stimulus in all its forms. As 2021 proceeds, we would suggest taking advantage of current and near-term volatility and any subsequent periods of market disorder, given the longer-term positive tailwinds for this asset class.

Riverbend and You

Our typical portfolios are comprised of:

- Essential service revenue bonds (water/sewer/electric utility)
- General Obligation bonds from states, cities, and counties with strong balance sheets and in many cases, multiple layers of support
- Higher education bonds from nationally recognized institutions with positive enrollment trends and significant endowments
- Healthcare facilities that are part of larger networks with dominant market share
- Transportation issues with consistent revenue streams and solid credit profiles

The portfolios we manage are conservative, defensive, and well-positioned for potential economic strain. We adhere to a disciplined strategy involving high quality credits and lower duration. Riverbend muni portfolios provide ballast in challenging times by balancing risk and offering stability in the midst of uncertainty.

Please feel free to contact us anytime if you'd like to discuss the topics cited in this update, or any others related to the municipal bond market.

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