1. Municipals Post a Strong Finish

In response to a volatile U.S. equity market and uncertainty regarding trade policy, investor expectations for future inflation reversed abruptly during the final quarter of the year. Potential future Fed rate action weighed heavily on markets and led investors to question whether the economic momentum in the U.S. will continue through 2019. The flight to safety trade drove demand higher for municipals, generally considered to be a source of stability and a ballast to equity variability. Despite the risk-off sentiment and subsequent decline in rates, municipals finished 2018 offering higher yields than this time last year. Additionally, on a tax adjusted basis, municipals outperformed other asset classes over the trailing twelve month period, driven largely by gains in the fourth quarter. *Exhibit 1*

While demand drove yields lower by year-end, off the highs of the third quarter, the relative steepness of the municipal yield curve versus the Treasury curve, in our opinion, indicates value in extending to the intermediate maturity range. The spread between AAA MMD 2-year and 10-year spots narrowed from 115 basis points (bps) to 51 bps over the three-year trailing period ending December 31st, 2018. However, this spread differential remains notably wider relative to Treasuries. *Exhibit 2*

Exhibit 1

Source: JP Morgan, Bloomberg LP

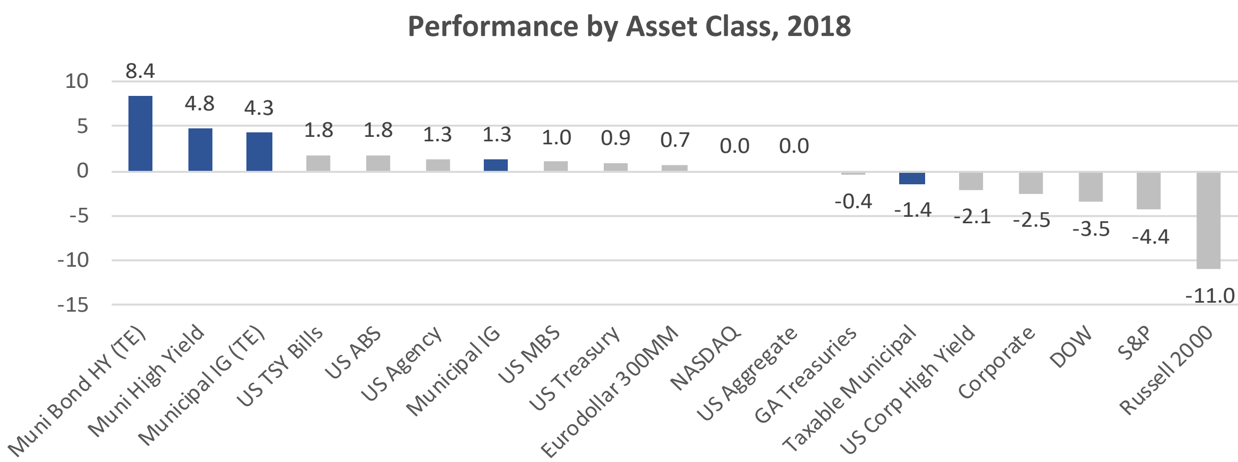
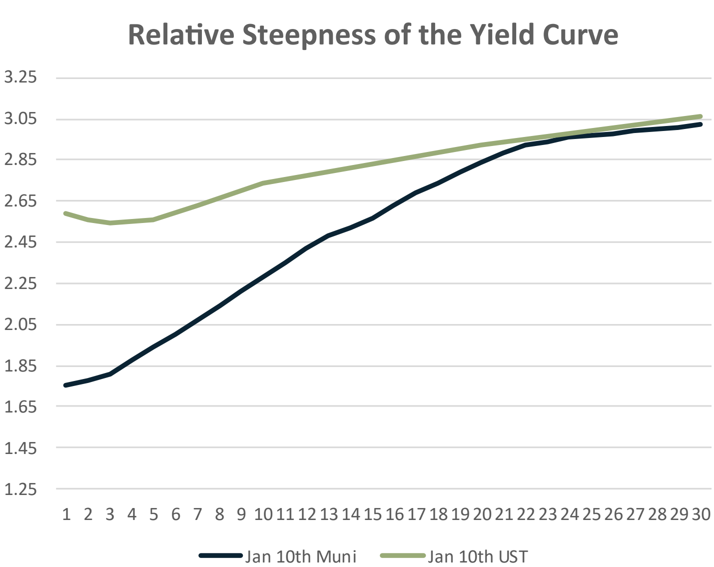


Exhibit 2

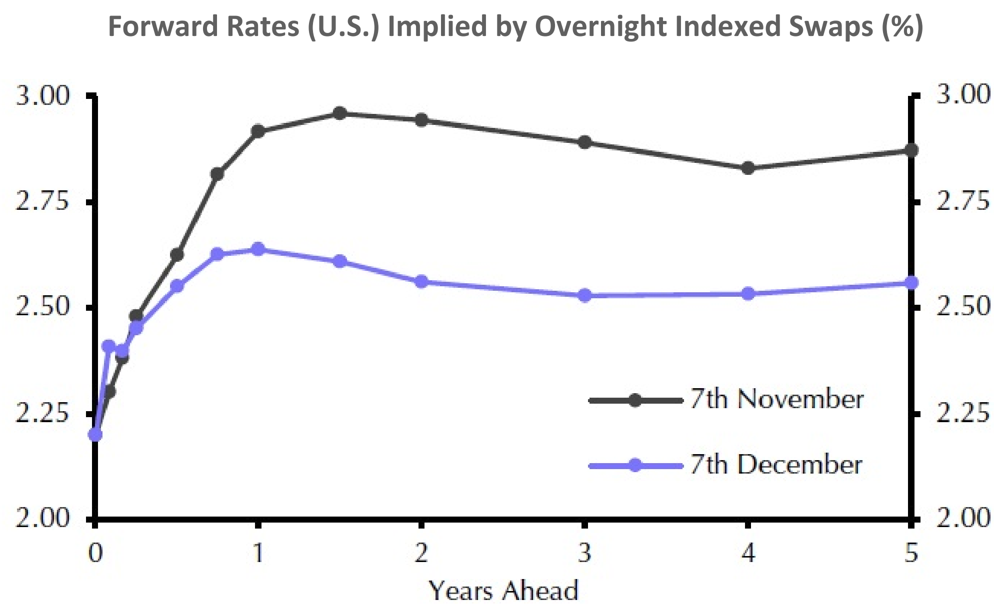
Source: Bloomberg



2. Market Expectations of Future Fed Rate Action

Exhibit 3

Source: Bloomberg, CE

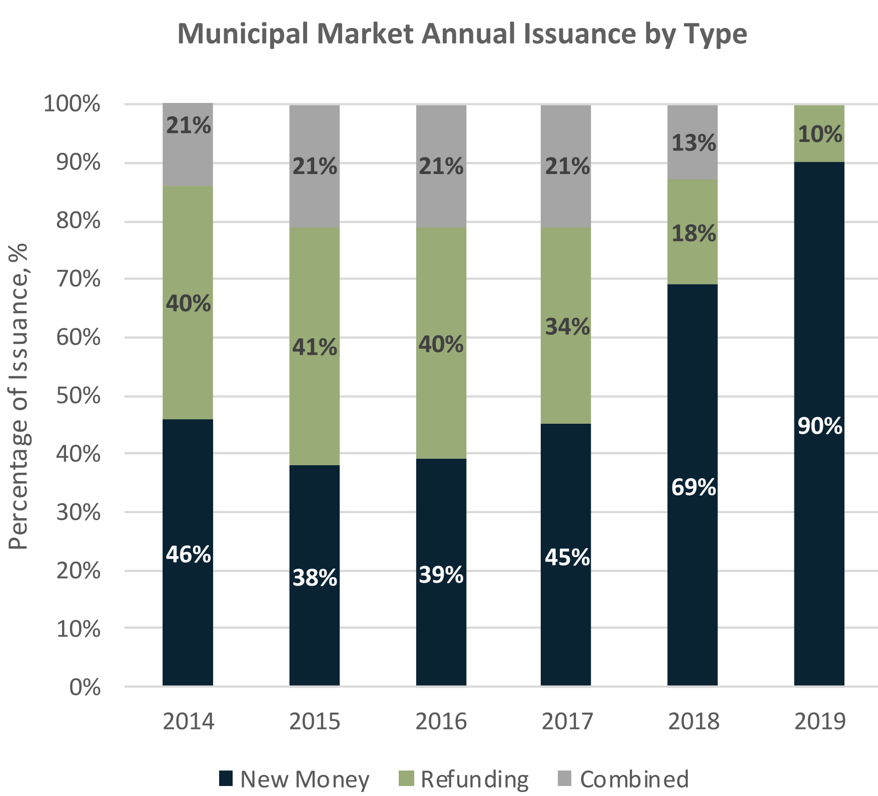


The Fed, despite raising interest rates at their final meeting of the year, cut their outlook for the U.S. economy from 2.5% to 2.3%, further fueling the volatility in the equity market post announcement. Fed Chair Jerome H. Powell noted, "a little bit of volatility ….. doesn't probably leave a mark on the economy." The decision to boost rates was unanimous with all voting members in favor of the rate hike. However, Fed officials were split on how many rates hikes might be likely over the coming year. Futures indicated that the market's expectations of future rate hikes have dropped off sharply. *Exhibit 3*

3. Municipal Market Supply

Exhibit 4

Source: Bloomberg, MMD



Total muni supply for the quarter came in at $86 billion, which brought 2018 issuance to $338 billion, or a decrease of 24% year over year. Furthermore, 2018 issuance was 14% below the trailing five-year average of $395 billion. The decrease in supply is attributable to the "move up in the calendar" that took place in late 2017, as issuers rushed to the market to get ahead of the elimination of advanced refunding issuance as part of the Tax Cuts and Jobs Act. As a result, refunding issuance totaled just $103 billion in 2018, 58% lower than in 2017. Interestingly, issuance for new projects, or "new money" issuance totaled $235 billion in 2018, the highest level since 2010.

Municipal flows turned negative during the last quarter of the year, with outflows totaling over $11.6 billion for the period. However, due to strong demand during the beginning of the year and increased demand for municipals in late December, overall inflows into municipal funds were positive for the year at $3.7 billion.

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