

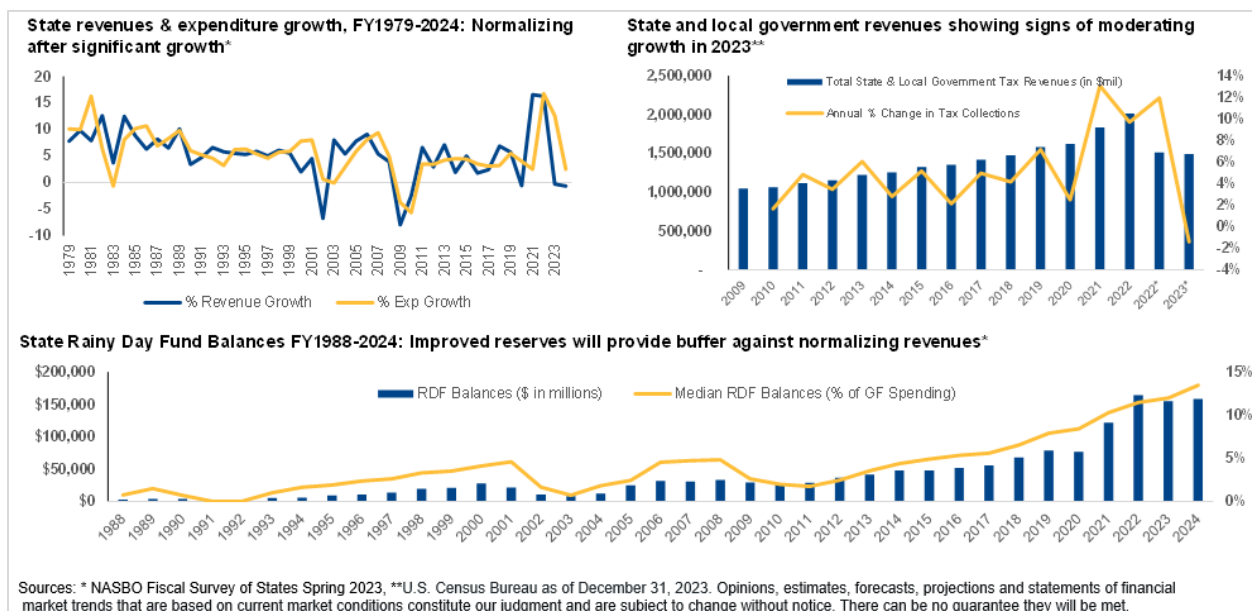
4/24/2024

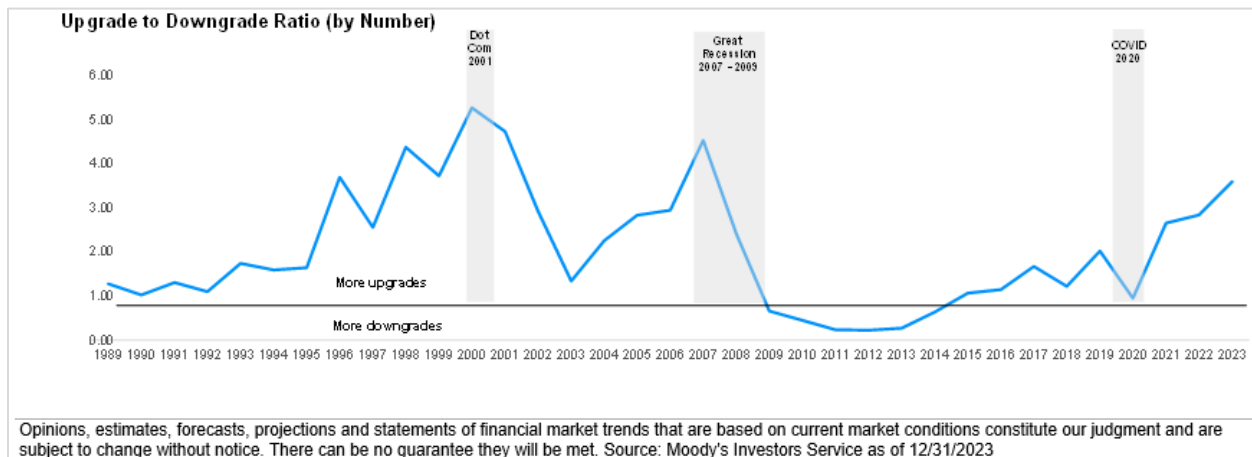
Summary: With tax season now behind (most of) us, tax-sensitive investors assessing the federally tax-exempt municipal bond market face a richer environment from a valuation perspective. The post-pandemic period has witnessed far more municipal bond demand than net new issue supply, contracting some parts of the after-tax municipal yield curve below that of U.S. Treasury yields.

We had an opportunity to meet with JPMorgan Asset Management for an in-depth discussion on the current fixed income landscape. The sector has seen across-the-board narrowing of credit risk premiums (the extra yield above U.S. Treasuries) required by investors to hold debt, including municipal bonds, considered riskier than Treasuries. Granted, a strong economy and fiscal support from the federal government make for a more conducive environment for taking additional credit risk. Investors should be mindful of whether their investments are being properly compensated with yield, including in the municipal market.

1. The Fiscal Outlook Looks Stable for Municipal Bond Issuers

- The fundamental backdrop can partially explain post-pandemic rich valuations of municipal bonds, between prudent budget management (i.e. aligning expenditures with revenue) and buildup of rainy-day reserves.
- Municipal bond issuers are also enjoying a positive ratings upgrade/downgrade ratio cycle, indicative of the ongoing economic expansion. Deterioration in this ratio typically begins at the onset of a recession.
- However, municipal revenue growth appears to be slowing down, as the initial burst of post-pandemic growth activity starts to fade as well as pandemic-level federal support.

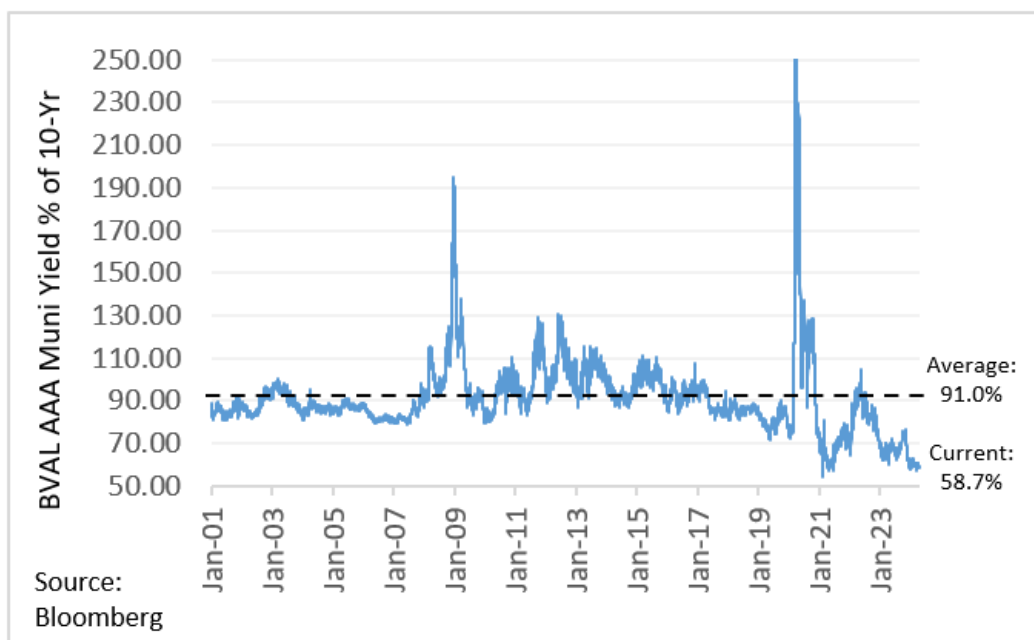




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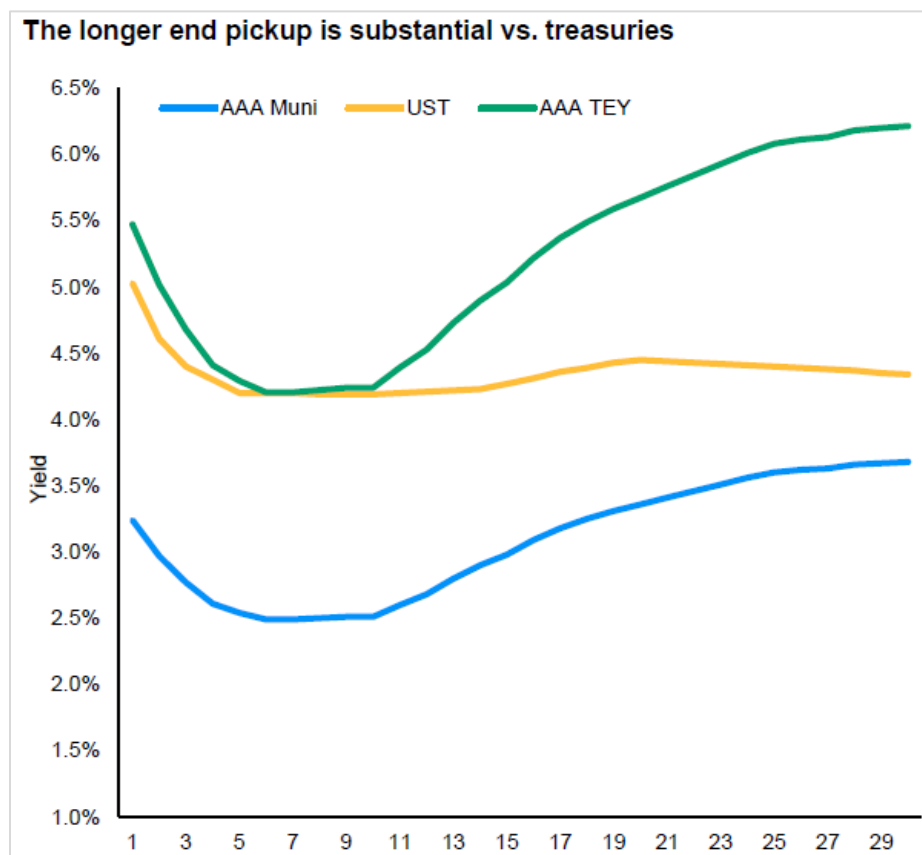
2. Top-Rated Municipal Bonds Trade at Historically Rich Levels versus US Treasuries

- The 2.74% yield on the Bloomberg 10-Year AAA-Rated Municipal Bond Index is well below the 4.66% 10-Year U.S. Treasury yield as of 4/16/2024. This ratio (blue line) sits just below 60% versus a long-term average of 91%.
- On a tax-equivalent basis, using a 37% federal income tax bracket, the AAA-rated municipal yield is only 4.34%. That is below that of the comparable U.S. Treasury yield.
- It would seem the post-pandemic period has introduced a new regime of greater appetite for safe after-tax investments as investors are willing to earn less on municipal bonds than U.S. Treasuries on a tax-equivalent basis.



3. Intermediate Maturities (7-10 Year) Are Especially Rich Versus Short and Long Maturities on a Tax-Equivalent Yield Basis (Green Line)

- At the end of the 1st quarter, the tax-equivalent yields of intermediate AAA-rated municipal bonds were nearly equivalent to that of U.S. Treasuries. This spread has since turned negative through the month of April.
- On a tax-equivalent basis, more value can be found in both the short and long ends of the municipal bond curve.
- The intermediate part of the municipal bond curve has historically been favored by tax-sensitive investors who are less inclined to purchase maturities beyond 10 years. However, it is less clear as to what is driving the current rich premium levels versus history. JPMorgan notes that muni-focused SMAs have grown to \$904 billion from around \$700 billion in 2019 while bank, insurance, and individual households have reduced their municipal bond exposures, implying that SMAs appear to be less price-sensitive versus the latter investor categories.



Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections and other forward statements, actual events, results or performance may differ materially from those reflected or contemplated. Sources: JPMAM and TM3. Charts as of 3/29/2024. UST yields from years 11-29 are interpolated averages. The tax rate used to calculate the taxable equivalent yield is 37% Federal tax plus 3.8% ACA tax.

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4. Be More Targeted in Your Municipal Bond Allocation

Fixed income remains attractive on an absolute inflation-adjusted basis, even municipal bonds on a tax-equivalent basis, especially if the U.S. economy experiences a soft landing of slow and steady growth. Advisors should be more deliberate in how they allocate client investments in the municipal bond market. Consider:

- Managed model offerings (mutual funds/ETFs), such as 3D Fixed Income-Tax Sensitive ETF Model and EQIS Municipal Fixed Income ETF.
- Laddered bond model portfolios such as EQIS 7 Year Muni ETF Ladder and the Invesco BulletShare Municipal Bond portfolios.
- Models from American Funds, BlackRock, First Trust, PIMCO, and VanEck.
- Dynamic/tactical models such as Clark Navigator Tax-Free Fixed Income Core and Ocean Park Municipal Bond.
- Replacing municipal bond allocation with a taxable fixed income allocation, such as investing in U.S. Treasuries that are as attractive on a tax-equivalent basis. Advisors can pair a government money market fund with the EQIS Long Term Treasury ETF Model to target the desired level of interest rate risk while earning attractive yields.

As always, come to us if we can guide you or assist you in any way. Reach out to your Consultant at consulting@freedomadvisors.com.

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