CIM 2Q 2019 Market Commentary

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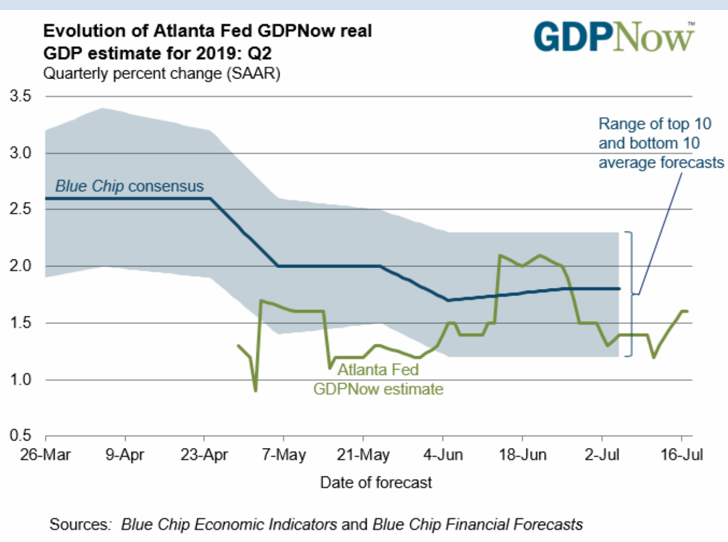
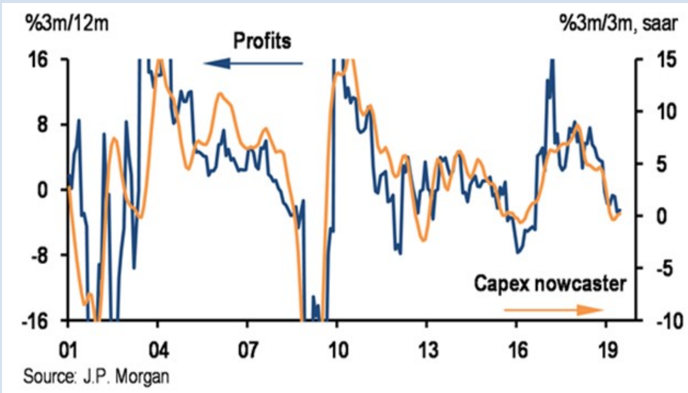
- **Depressed corporate earnings guidance, resulting in further reductions in capital expenditures, are sure to weigh on US GDP growth in the months ahead.**
- **Cass Freight report, "material downside risk to the economic outlook" may indicate economic contraction.**
- **If the Fed cuts rates it is highly unlikely to raise rates for the next 25 to 50 meetings.**
- **Munis have outperformed the S&P 500 on a taxable equivalent basis over the previous twelve months.**
- **We expect municipal bonds to continue to perform well in the months ahead.**



The second quarter saw a continuation of the powerful rally in fixed income markets which began in the first quarter as markets, across the globe, priced in the probability of a further slowdown in global economic activity. Expectations increased for the Federal Reserve to ease financial conditions through lower interest rates. This was an extraordinary reversal, given that the Fed last raised the Fed Funds rate, just a few short months ago, in December 2018. The Fed is now considering reducing interest rates in an effort to arrest recent softness in economic growth in the hopes of extending the longest economic expansion in US history. Risk markets have responded positively to this news which is unexpected given the deteriorating outlook for corporate profitability and profit margins more broadly. In light of weakening pro-cyclical sectors, such as autos and housing, it was not surprising to see the most recent Atlanta Fed GDPNow forecast, for Q2 GDP growth, indicating clears signs of slowing. As you can see in Figure 1, GDP growth expectations now sit just above 1.5%. This is a significant drop from Q1's GDP growth rate of over 3%. In addition, the Cass Freight Index, which measures the monthly aggregate deliveries of freight in the US, fell by -5.00% in June. This followed a -6.00% decline in May. According to the Cass Freight report, declines of this nature point to "material downside risk to the economic outlook" and may indicate actual economic contraction. Therefore, a return to materially faster economic growth is unlikely in our view, absent a substantial trade deal with China. Not only does a trade deal need to be agreed upon, but it also must be passed by an extremely divided Congress. Given that the renegotiated North American Free Trade Agreement, called the USMCA, has yet to be brought before the House of Representatives for a vote, it is difficult to see, with the Presidential election season upon us, how any US/China trade deal could be implemented in the near-term. Political gridlock is likely to persist throughout the election cycle. In our view, depressed corporate earnings guidance, resulting in further reductions in capital expenditures, are likely to weigh on US GDP growth in the months ahead, see Figure 2.

Figure 2 **Global Corporate Profits and Capex**



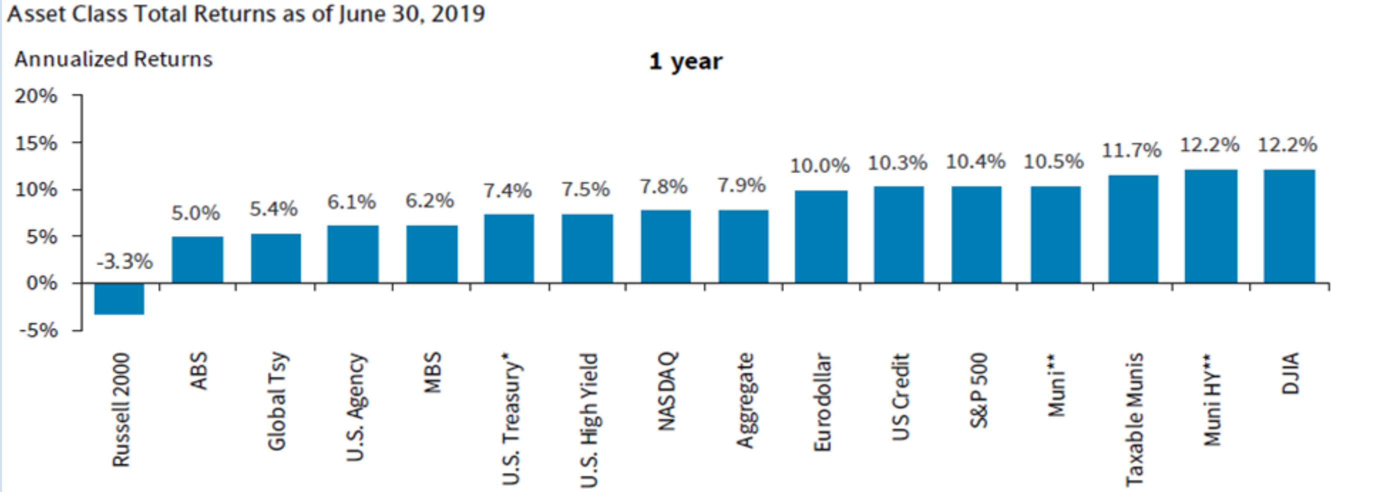
When we consider that the Fed is likely to cut interest rates this month for the first time since the Credit Crisis in 2008, the gravity of this moment is not lost on us. History has shown that the Fed is unlikely to raise rates for a very long time. According to former Fed Governor, Narayan Kocherlokata, "if history is any guide, the Fed is highly unlikely to be willing to raise rates for the next **25** to **50** meetings". The good news is that inflation should remain subdued for an extended period. Fixed income investments, therefore, will likely prove to be an attractive investment vehicle in the face of rising uncertainty in the months and years ahead.

Municipal bonds, in particular, have historically performed well during periods of slow growth and economic recessions. We firmly believe that the attractive taxable equivalent returns municipal bonds provide will increasingly attract new investors to the space over time. For example, the Bloomberg Barclays Municipal Bond Index has delivered a taxable equivalent return of 10.5% year-over-year, assuming one is on the highest tax-bracket. It will surprise many Wall Street strategists to learn that, on a taxable equivalent basis, **munis have outperformed the S&P 500 over the previous twelve months**, see Figure 3. Given the considerably lower level of risk inherent in municipal bonds, the asset class continues to demonstrate why it should remain a substantial portion of one's long-term asset allocation. Moreover, tax-reform and the loss of tax deductions for tax-payers in every state, especially high-tax states, have raised the relative attractiveness of the tax-free income that municipal bonds provide. Given the low probability that a rolling back of tax reform will occur in the near-term, we expect municipal bonds to continue to perform well in the months ahead.

As we enter the back half of 2019, the developing economic environment is consistent with the expectations we shared in our Q4 2018 Market Commentary. A continuation of the slowdown in US economic growth, while not catastrophic, will no doubt weigh on the minds of consumers, investors, and CEO's in the weeks and months ahead. We expect a weakening of confidence to result in reduced personal consumption and capital expenditures over time. We,

Figure 3

Asset Class Total Returns as of June 30, 2019



Note: Taxable equivalent returns: * US Treasury income is exempt from state income taxes and is adjusted using a national state average (top bracket), net of federal income tax. ** Based on an equally weighted national average federal and state (top bracket) income tax rate; local taxes have not been considered.
Source: Bloomberg, Bloomberg Barclays Indices, Barclays Research

therefore, believe investors are sufficiently incentivized to seek safety in the security of municipal bonds, enjoying the benefits of tax-free cash flow, while they await rising, economic uncertainty and the ultimate end of the current business cycle.

We are very proud to share that Clinton Investment Management was once again recognized by Informais as one of the best municipal bond managers in the country, as we were awarded Informais' *PSN Top Guns Award* for the eighth consecutive quarter.

If you should have any feedback or questions you would like to share regarding this commentary or the municipal market more broadly, please feel free to reach out to us directly.

Sincerely,

Andrew Clinton

CEO

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