CIM 3Q 2019 Market Commentary

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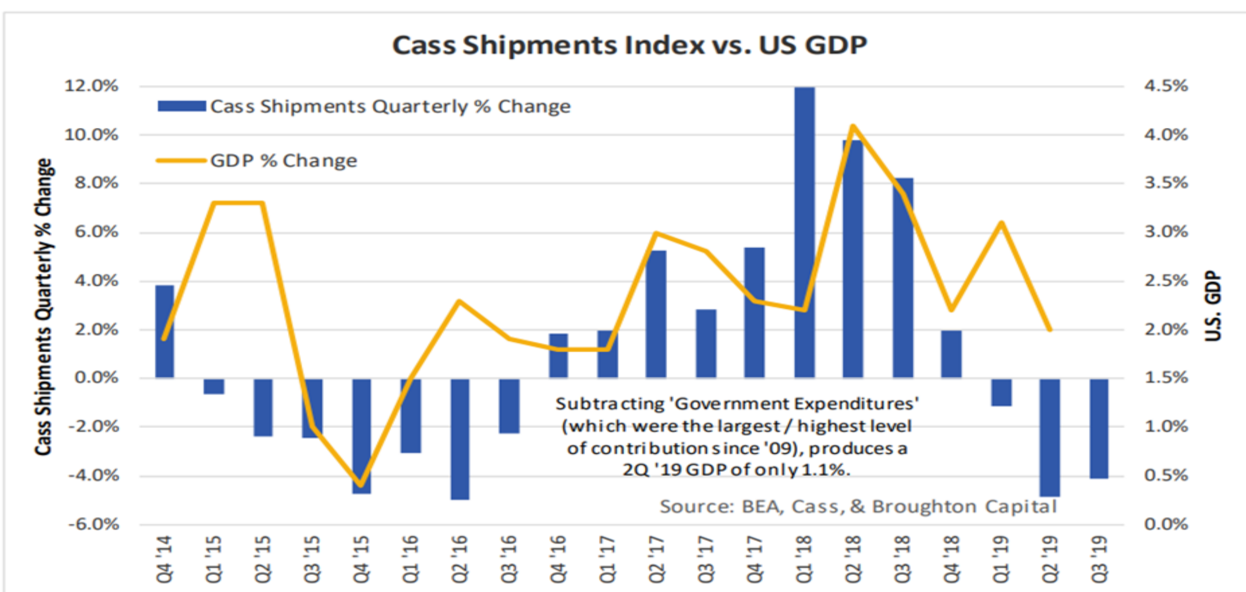
- **Federal Open Market Committee (FOMC) chose to cut the Federal Funds rate not once but twice during the quarter.**
- **The Fed was forced into action by broad declines in global and domestic purchasing managers activity.**
- **CEO's are now less confident about the future than at any previous time since the global financial crisis in 2008.**
- **CIM's MCO and MD strategies have delivered strong 12 month returns of 11.30% and 9.44% respectively.**
- **Municipal bonds, YTD, are delivering returns that are among the strongest on an absolute, risk-adjusted, and taxable equivalent basis.**
- **In the months and years ahead, wealthy tax payers will increasingly seek the safety and attractive tax-free returns municipal bonds deliver.**

The third quarter brought with it a dramatic shift in Fed policy as the Federal Open Market Committee (FOMC) chose to cut the Federal Funds rate not once but twice. The Fed's decision marked the first interest rate cut since the credit crisis of 2008, indicating a clear inflection point in monetary policy and providing an ominous signal to the markets in our view. The FOMC's actions reflect its deep concerns regarding meaningfully weaker economic conditions. The Fed was forced into action by broad declines in global and domestic purchasing managers activity and a significant contraction in capital spending and shipping during the quarter, see Figure 1.

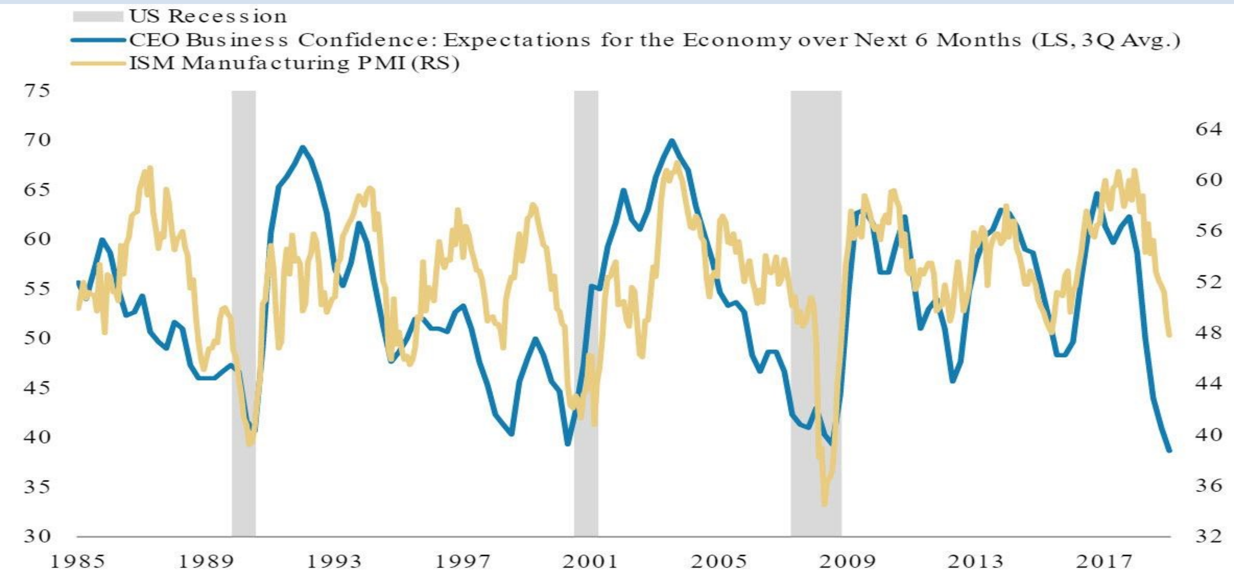
Figure 1



The realization by bond markets, around the globe, that we are approaching an end to the more then decade long, global, synchronized, economic expansion, forced interest rates dramatically lower across the yield curve. The yield curve subsequently inverted, when long-term rates fell below short-term rates. Over the course of US history, yield curve inversion has proven to be an extremely accurate predictor of economic contraction and recession in the months ahead.

Yields on 10-year and 30-year Treasury bonds fell significantly, by 34 and 41 basis points respectively, during the quarter, resulting in a surge in bond prices. Rising uncertainty over the escalating US trade war with China, together with the onset of what is likely to be an extremely contentious US Presidential election season, is adding to pressures on CEO and investor confidence. CEO's are now less confident about the future than at any previous time since the global financial crisis in 2008, according to a recent Conference Board survey, as seen in Figure 2. The third quarter also saw risk assets and equity markets fluctuate dramatically as fear of deteriorating corporate profitability took hold.

Figure 2

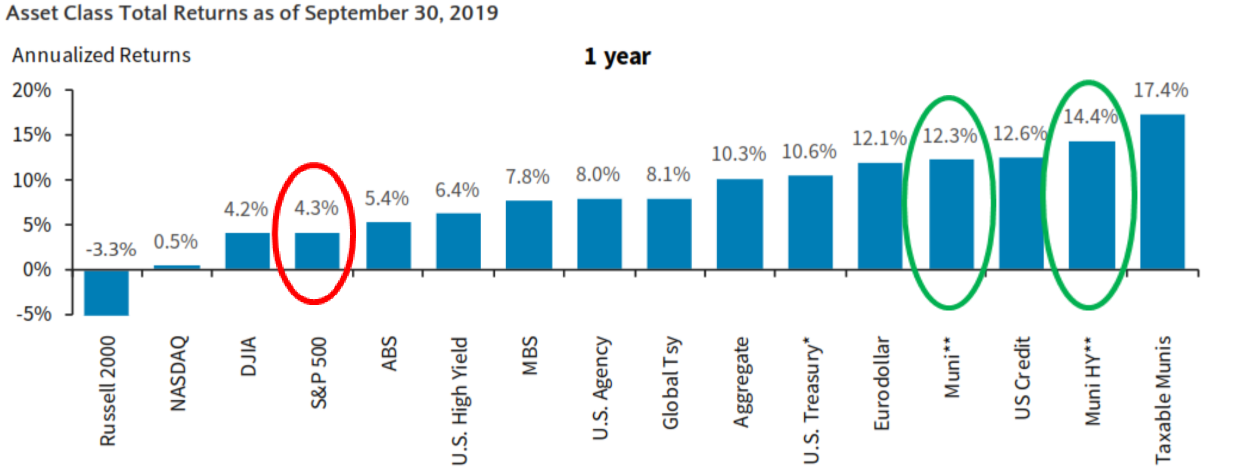


Source: Morgan Stanley US Equity Strategy Research

Municipal bond yields also declined during the quarter, falling by over 20 basis points and 30 basis points for 10 and 30 year bonds respectively. Clinton Investment Management's (CIM) clients were well- positioned for this shift in market sentiment. As our clients and loyal readers know, we have been expecting an economic slowdown and subsequent decline in interest rates for some time. We proactively positioned client portfolios accordingly. As of 9/30/2019, CIM's Municipal Credit Opportunities and Market Duration strategies have delivered strong returns, 11.30% and 9.44% respectively, over the last 12 months, net-of-fees. These returns are among the highest in the municipal, separately managed account industry, according to Informais.

Municipal bonds remain in favor with investors. Inflows into our strategies, as well as the broader municipal bond fund community, continue at a record pace, year-to–date. There are clear signs that clients are beginning to de-risk as the past decade's extraordinary bull market in risk assets comes to an end. Municipal bonds, year-to-date, are, once again, delivering returns that are among the strongest on an absolute, risk-adjusted, and taxable equivalent basis, see Figure 3. This is noteworthy as the municipal bond market was the best performing asset class in 2018 as well.

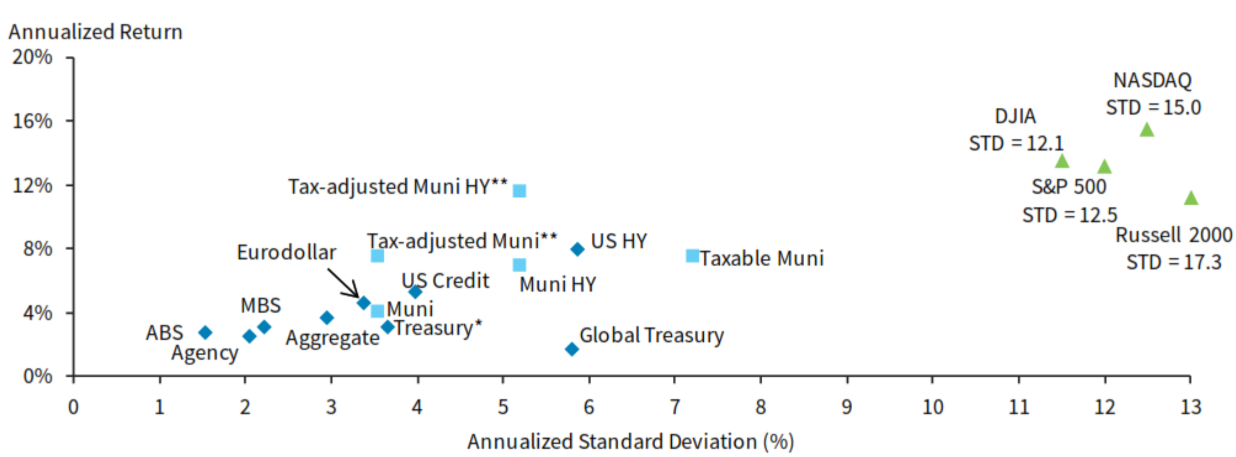
Figure 3



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

As shown in Figure 4, high grade and high yield municipal bonds have delivered the strongest, risk-adjusted returns, on a taxable equivalent basis, over the past ten years, according to Bloomberg Barclays Research.

Figure 4



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Source: Bloomberg, Bloomberg Barclays Indices, Barclays Research

The decline in yields, more broadly, has made the absolute level of yields in the front-end of the municipal bond curve considerably less compelling in our view. Yields on AAA-rated municipal bonds, out to seven years, are now just over 1.00%. Given that we do not expect a move higher in yields any time soon, low yields will likely incentivize investors to consider moving away from traditional passive, buy and hold, strategies. In our view, low absolute yields for longer will increasingly drive investors to seek the additional total return that professionally managed strategies can deliver. In this regard, we are tactically overweight longer, intermediate maturities while we maintain an under-weight position in short maturities and the richest specialty state credits, including California, New York, and New Jersey. Residents of these states have been hit particularly hard by the 2017 tax law that prohibited the deduction of state and local taxes (SALT). This has created tremendous investor demand for municipal bonds within those states, depressing yields further. Yields are now at levels which allow residents, within those states, to invest in bonds from other states and pick up yield after-tax. This is a rare occurrence. It is an inefficiency we believe investors should capitalize on in the near-term in order to increase after-tax cash flow over time. We believe the recent move by investors, to increase their allocations to municipal bonds, could also accelerate as they begin to assess the probability of a Democrat Presidential victory and rising risks of a wealth tax, increased capital gains taxes, and a reversal of the tax cuts of 2017.

As we look to the final quarter of the year, our outlook remains the same. We expect the slowdown in economic growth to continue. As the economy slows and recession risks increase in the months ahead, we are mindful of the fact that, during prior recessions, the Fed has needed to cut interest rates by 5.00% to 7.00% to revive the economy. Yet, today, we sit at a Fed Funds rate of just 1.75%. This reality increases risks and uncertainty for investors going forward. While we believe the next recession may not be as deep as 2008, we are concerned that the duration could be considerably longer, given the limited tools available to the Fed to stimulate the economy. Therefore, due the relative stability and consistency with which municipal bonds have delivered true value to investors over time, we are confident that, in the in the months and years ahead, wealthy tax payers will increasingly seek the safety and attractive tax-free returns municipal bonds deliver.

Should you have any questions about this commentary, or the municipal bond market more broadly, please do not hesitate to contact us directly.

Kindest Regards,

Andrew Clinton

CEO

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