ASSET PRESERVATION ADVISORS

Market Commentary | Q1 23

FIRST QUARTER HIGHLIGHTS

The municipal market ***started the year with prices moving higher*** as the seasonal supply/demand imbalance known as the "January effect" took hold.

After a solid start to the year, ***municipal performance reversed course in February*** as a shift in economic data readings drove the selloff in bonds for the month.

State and local government ***returns were boosted by a flight to safety in March*** amid concern around the banking industry and the collapse of several regional US banks, which reverberated through markets.

New issue supply for the ***first quarter came in at just $76.1 billion, a decline of 26.4%*** year over year.

After seeing record outflows of $148 billion in 2022, ***municipal fund flows turned positive for the first quarter of 2023***.

Broad municipal performance was positive in Q1 as AAA tax-exempt yields moved lower by 22, 30, 36, and 28 basis points ("bps") in the 2, 5, 10, and 30-yr spots, respectively.

QUARTERLY MARKET UPDATE

The municipal market started the year with prices moving higher as the seasonal supply/demand imbalance known as the "January effect" took hold. The strong technical environment helped municipals outperform the rally in Treasuries as demand in the form of fund inflows and robust reinvestment income coupled with limited supply provided support for the asset class. Per Investment Company Institute ("ICI") data, fund flows totaled +8 billion for January after the asset class saw record outflows in 2022. Issuance for the month totaled just $23.1 billion, or a decline of 12% year over year. Economic data released in January indicated the economy cooled in the fourth quarter, while inflation also showed signs of moderating. However, the labor market continues to remain tight, pressuring wages.

After a solid start to the year, municipal performance reversed course in February, following the guidance of the Treasury market. A shift in economic data readings drove the selloff in bonds for the month. The payroll report showed a large beat over expectations, while inflation readings later in the month showed that inflation remained entrenched. Core CPI increased 0.4% month over month and 5.6% from a year ago, versus estimates of 0.3% and 5.5%, respectively.

At the FOMC meeting in early February, the committee increased the fed funds rate by 25bps and acknowledged inflation "has eased somewhat but" remains elevated. Many market participants took the Fed's revised statement as an indication of being near the end of their tightening cycle.

Municipals were pressured by fund flows decreasing but remained positive for the month. A continued supply drought supported the asset class, as issuance totaled just $20.6 billion for February, a decline of 35% year over year.

In credit news, S&P upgraded Illinois' GO debt from BBB+ to A-, a level last seen for the state in 2015. The rating agency cited a "commitment and execution to strengthen its budgetary flexibility and stability, supported by accelerating repayment of its liabilities, rebuilding its budget stabilization fund to decade highs" in its action.

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The month saw wide swings in yield in the bond market as a divergence emerged between the market and the Fed. The 2-year UST yield climbed to 5.05% on March 8th (the highest level since 2007), before rallying by nearly 100bps to close the month. The UST 2-10 year spread steepened (became less inverted) by 40bps during this period, as the market began to price in cuts while Chair Powell indicated that rate reductions in 2023 remain unlikely.

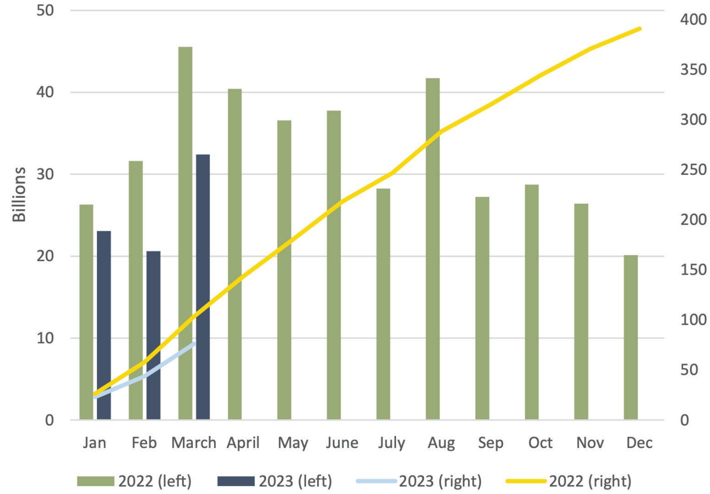
In their March meeting, the Federal Open Market Committee (FOMC) increased rates by 25 bps and signaled a potential slowdown in the pace of future rate hikes. The statement highlighted the Committee's intention to implement additional policy firming, if necessary, to achieve a sufficiently restrictive monetary policy stance and bring down inflation.

Issuance picked up in March during what is seasonally a larger month of issuance, as supply totaled $32 billion for the period. While this was an increase month over month, this was a decline of 29% year over year as supply continues to lag historical levels.

SUPPLY

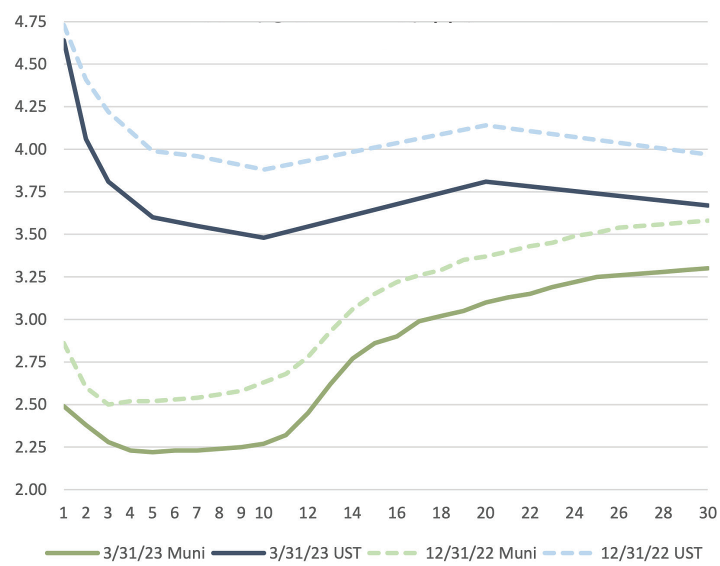
New issue supply for the first quarter came in at just $76.1 billion, a decline of 26.4% year over year. The drop in supply is attributable to several factors, including issuers being more selective and opting to build up reserves and higher yields making refunding less attractive. Per Securities Industry and Financial Markets Association ("SIFMA") data, year-to-date refunding issuance is down 45% over the same period last year.

MUNICIPAL MARKET SUPPLY



Source: SIFMA

MUNI & TREASURY YIELD CURVES

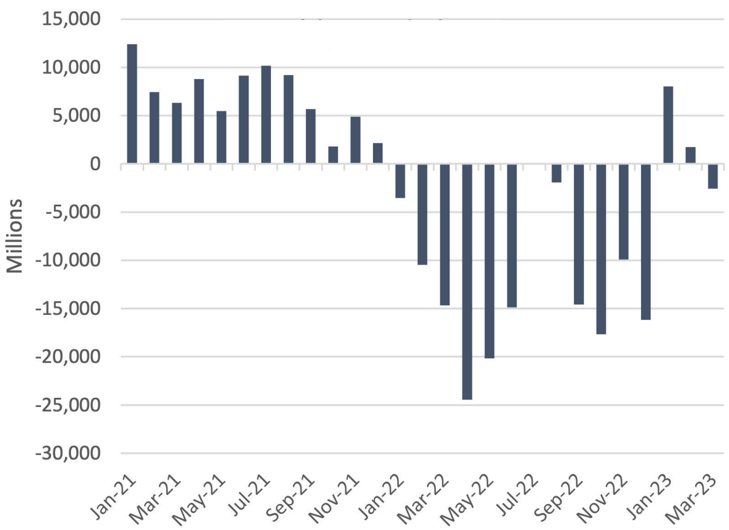


Source: Municipal Market Data, US Treasury

FUND FLOWS

After seeing record outflows of $148 billion in 2022, municipal fund flows turned positive for the first quarter of 2023. Per ICI data, January and February saw net inflows of $8.03 and $1.76 billion, respectively, while March saw net outflows of $2.58 billion. Flows could remain pressured through the historically seasonally challenging tax period but could pick up following that as investors could become more active with more clarity from the Fed around rates.

MONTHLY FUND FLOWS



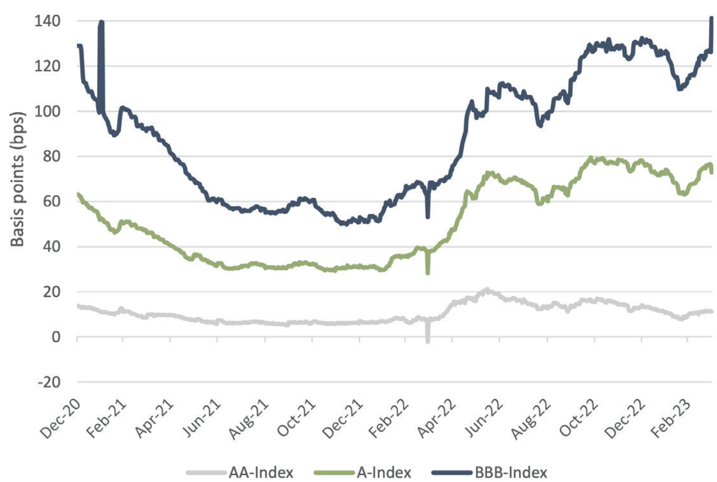
Source: ICI, Barclays

OUTLOOK

Broad municipal performance was positive in Q1 as AAA tax-exempt yields moved lower by 22, 30, 36, and 28 bps in the 2, 5, 10, and 30-yr spots, respectively. A strong technical environment of robust maturity and coupon reinvestment demand and low new issue supply supported the asset class. While supply could pick up as the Fed downshifts its tightening path, we expect this same force, coupled with generally higher nominal yields, to bring potential investors off the sidelines. Thus, after allowing duration to drift lower for much of 2022 in the face of higher rates, we have been actively executing trades to extend portfolio duration more in line with long-term targets with reinvestment from maturity roll-off and through the execution of beneficial tax-loss swaps.

Additionally, we believe the municipal credit profile remains stable. Municipal issuers have chosen to pay down debt, be more selective in new issuance, and build cash balances ahead of a potential slowdown. Revenue collections have remained stable, and local governments continue to reap the benefits of the boost provided by fiscal aid. Illinois and New Jersey received recent rating agency upgrades, and broad market upgrades have outpaced downgrades significantly over the past year, reflecting the strength of the asset class. While APA remains conservative in its approach to credit, we will look to uncover pockets of value to selectively add lower-rated positions (within strategy mandates) with strong underlying metrics that we believe are well-positioned to weather any potential economic slowdown.

CREDIT SPREADS



Source:Bloomberg, ICE Data, Bank of America
(YTW of AAA, AA, A, BBB-Rated ICE BofA Indices).

ABOUT APA

Asset Preservation Advisors (APA) is a registered investment advisor founded in 1989. APA specializes in managing high quality tax-exempt and taxable municipal bond portfolios for other registered investment advisors, family wealth offices and institutional clients.

Since its founding, Asset Preservation Advisors is committed to delivering a high level of service, quality and wealth preservation. APA believes our growth in assets under management can be attributed to a consistent investment process and corresponding trading discipline.

We value highly the trust our clients have shown in APA and remain committed to adhering to a high level of ethical, moral and business standards first envisioned at our founding in 1989. Asset Preservation Advisors (APA) is a registered investment advisor founded and specializes in managing high quality, tax-exempt and taxable municipal bond portfolios for other registered investment advisors, family wealth offices and institutional clients.

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