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Charles W. Fish

Chairman and Chief Investment Officer

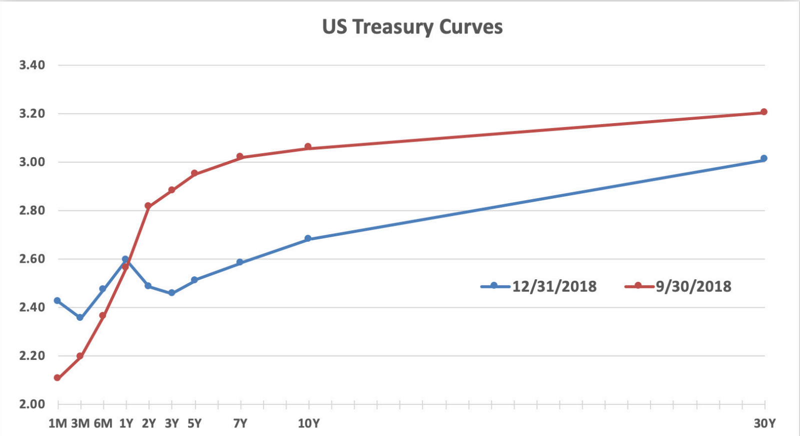
Letter from the Chairman… January 2, 2019

"I have enough money to last me the rest of my life, unless I buy something." – Jackie Mason

Doesn't it seem twisted logic to vote to spend money you don't have and then require a separate vote to authorize going further into debt? Doing so is never straightforward. It is inevitably encumbered with political agendas. Fortunately, states and their political subdivisions can't monetize their deficits like the federal government. When they wish to add an expense, they will need to raise revenues or reduce spending in some other area(s). When, like the federal government, they try to circumvent reality by choosing to underfund an entitlement, their problem is only compounded.

As we get rolling (government shutdown not withstanding) on 2019, I thought I'd share some points that may influence your thinking:

1. The economic outlook for China and Europe in '19 has moved significantly lower.
2. Everyone has lowered their outlook for inflation for 2019 - notably below the 2% Fed target.
3. When the 10-year Treasury was at 3.23% last October, most pundits predicted the year-end level at 3.5%. The 12/31/18 actual close was 2.69%.
4. Despite low interest rates, the federal government's interest expense on its debt in fiscal '18 was the highest in our history. It will be higher still in fiscal '19 as the tax cuts of last year will fail to generate sufficient revenue growth.
5. The Fed has trimmed its expected rate hikes in '19 to only two. The bond market expects only one, and zero in 2020.
6. For those thinking that the yield on the 10-year Treasury can't decline any further, I remind them that as recently as July of 2016, it closed at 1.37%.
7. In early October, you could purchase 4-year AA-rated California bonds earning 2% tax-exempt. By December, you would need to extend out to almost 7 years to obtain the same yield.
8. Bloomberg, quoting the Treasury, stated that in fiscal '18 individual income taxes rose 6.1% while corporate tax receipts dropped 31%.
9. The graph shown below plots the Treasury yield curves as of 9/30/18 and 12/31/18. As you can plainly see, the yield on the 3-year Treasury is now well below the yield on the 1-year.
10. The demand for California municipal bonds will grow in 2019 (due in large part to the cap on state tax deductibility). The supply won't.
11. Once again, we are urging all our clients to talk with their accountants/CPAs as soon as possible about their 2018 tax liability. CFI is concerned that some may be underestimating their obligation due to the new $10,000 cap on SALT (State and Local Taxes) deductions.
12. The task of raising yields on our clients' municipal bond portfolios in 2019 may be challenging. We will do our very best.



Announcement:

CFI is pleased to report that our Director of Research, Betsy C. Shelton, has been elected to the Board of Directors of the National Federation of Municipal Analysts (NFMA). Betsy's appointment to the NFMA board will provide an opportunity to voice our concerns regarding regulatory practices that affect our client portfolios. **Congratulations Betsy.**

Wishing you a happy, healthy and prosperous new year.