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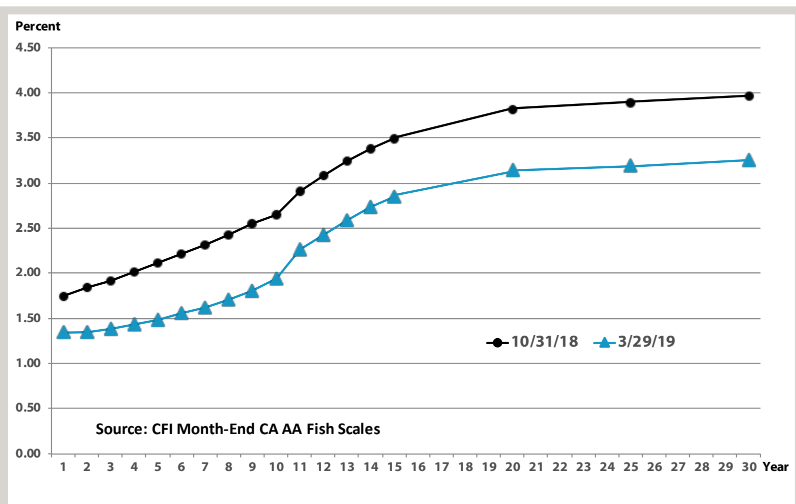
Charles W. Fish
Chairman and Chief Investment Officer

Letter from the Chairman… April 1, 2019

"Every now and then it helps to be a little deaf."
Ruth Bader Ginsburg

I wish I had said that. You will note that most economists calling for higher interest rates last October were wrong. Since then, municipal bond yields have dropped about 60 basis points (see graph below). This reduces their return to less than 80% of Treasuries which should raise a caution flag. Economists being dead wrong is nothing new and it is not the point. Implicit in their reasoning is the presumption that market timing should govern a portfolio managers actions. We disagree and so does history. This is because errors in market timing strategies are so costly. One mistake can take years to overcome. As Bismarck said, "A little caution outflanks a large cavalry." If you stampede in a different direction every six months, you are bound to trample any good you have done.



Long term superior performance is secured through good asset allocation, tactics and hard work. The best results are achieved when you concentrate where the competition is weakest: in the secondary market, on smaller blocks (under 500M) of bonds and where credit knowledge (not the rating agencies' opinions) is required.

Propelled by an avalanche of new money entering the municipal market,* yields available in the primary (new issue) market seem less and less appealing. Yet opportunities abound for those willing to do the work. Buying a block of bonds out for bid at a compelling price might have required entering a dozen or more bids that were unsuccessful.

The research required to enter intelligent bids on each is significant, so choosing your targets well is also important. Because we actively manage each portfolio, CFI needs to be just as skilled at selling bonds. The current strength in the market provides opportunities to sell at or through the offered side of the market. More on that subject another day.

Because conventional hedging of municipal bond portfolios is both expensive and unreliable, CFI chooses to provide their defense by maintaining a meaningful portion of each portfolio's assets in short bonds. Maintaining this discipline provides a ready reserve should it be needed to facilitate a swap. As more bonds roll into this short arena, more become available for swap. This is especially true in the current interest rate environment that allows the sale of short items at yields below 2%. The old military maxim that the best defense is a strong offense may have it backwards. In portfolio management, it seems the best offense is often a strong defense.

Despite the decline in yields, waiting for them to rise significantly could prove long and costly. The Federal Reserve, for its part, has adopted a neutral posture. They are indeed "data dependent" and unlikely to collect sufficient data to justify raising or lowering rates anytime soon. We are as polarized as ever politically and compromise is not on either side's agenda. Nevertheless, the world's economies are as interdependent as ever and the evidence is on the side of global slowing. Some $10 trillion of developed economies' debt is now trading at negative yields – a late cycle omen.

Justice Ginsburg has it right – you need to be a little deaf now and then.

* According to Investment Company Institute, over $25 billion have been added to ETFs and muni mutual funds in the past three months. This is more than twice the amount added in the same period of 2018 and over three times that added in the first quarter of 2017.