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Charles W. Fish
Chairman and Chief Investment Officer

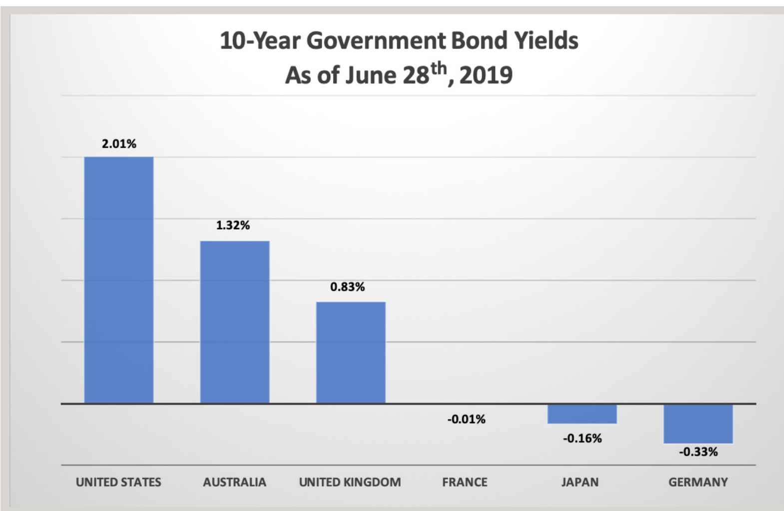
Letter from the Chairman…

July 1, 2019

"I hate housework. You make the beds, wash the dishes, and six months later, you have to start all over again." *Joan Rivers*

You can't manage a municipal bond portfolio like Joan Rivers kept house. Like a home, it needs attention daily. The relatively low interest rate environment that now prevails makes the task of acquiring attractive bonds formidable, but it also makes it easy to sell bonds at very competitive prices. The weakness in the global economy is palpable. Here at home, the top 1% can only buy so many widgets and they won't go out for dinner more than once a day. The evidence is crystal clear: the middle class must grow and prosper, or the economy can't grow and won't prosper. When tax receipts stagnate, and they will, deficits will continue to climb.

There are a few arguments suggesting a rise in interest rates during the next year. None are compelling. The case for rates staying low or going even lower is powerful. Specific to municipals, the strong demand is coupled with technical factors compounding the problem. The amount of municipal debt outstanding, according to SIFMA[1], has shrunk ten percent from a decade ago. Without the reinstatement of advance refunding issues, supply is poised to decline further.



A recent Wall Street Journal article[2] implied that non-rated muni bonds were synonymous with junk munis – those with an elevated chance of defaulting. Bringing attention to the risks present in the type of debt they were citing is laudable. The fact that a rating wasn't purchased on a bond usually allows it to be acquired at higher yield than comparable rated bonds. It does not automatically consign the borrower's credit strength to junk.

Smaller blocks of non-rated bonds are frequently ignored by many bidders. The absence of competition presents opportunities. A non-rated bond may have been issued many years ago. Although perceived as speculative back then, the debt now has an enviable value-to-lien ratio and near zero delinquencies. Their financial disclosures have always been current, and the bond covenants are satisfactory. Debt per capita, while moderately high when the issue came to market many years ago, is now small and new issuance is neither needed or contemplated. Of course, to know all this one would have to do some digging.

If, you may ask, one can buy this strong a credit at higher yields, why not load the boat? The answer is self-evident. Their availability at higher yields is due to their diminished liquidity. It would be imprudent to have too large a portion of one's portfolio unrated. Liquidity is vital to a portfolio in order to take advantage of, and not fall victim to, credit risk, interest rate risk, litigation risk, legislative risk, event risk, etc.

One of my favorite authors, David McCullough, stated that when writing a book "…you gather research – start writing – then you find out what you don't know." There is a great deal that we do not know. Will the Fed lower the funds rate once, twice, perhaps three times by the end of the year? Will that really improve the economy or simply justify higher stock and bond prices? Will additional tariffs lead to more protectionism, exacerbating the global slowdown? Will political strife during and after the election continue to paralyze needed legislation on infrastructure, immigration, education?

As the chart above illustrated, the U.S. 10-Year Treasury has plenty of room to decline in yield from present level. Bond bulls would also point out that as recently as three years ago (07/05/2016) our 10-Year Treasury yield was only 1.37%. Few anticipate a US recession or deflation, while inflation fears seem simply to have melted away. Lots to worry about. And then there is Winston Churchill; "when I look back on all these worries, I remember the story of the old man who said on his deathbed that he had had a lot of trouble in his life, most of which never happened."

[1] Securities Industry and Financial Markets Association [2] May 28, 2019: "Rising Municipal Bonds Keep Up Hot Streak"