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Tax exempt bonds have had a nice rebound this year after a volatile 2016 and have returned a solid total return of 3.48% YTD¹. The performance has been primarily technically driven as fund flows have been positive and overall supply is down 17% YOY. Muni/Treasury 10-year ratios are now at their tightest since last August (see graph below). Our market has also clearly benefited from political turmoil surrounding President Trump that has cast doubt on major policy reforms being enacted in 2017. While we continue to believe that the municipal bond tax exemption is safe, federal policy risk for our asset class remains high, and is not currently reflected in some muni sector's rich relative value.

Munis Outpace Treasuries

Yields fall to lowest against federal debt since August



One of the largest unknowns at this point facing municipal credit is the status of the Affordable Care Act (ACA) and the strong possibility of reduced Medicaid funding. A few weeks ago, the House passed a repeal and replace ACA bill, but it's uncertain at this time what will happen to the bill in the Senate. The proposed Trump budget had Medicaid cuts above the House's Republican health care plan and funding moving toward a block grant model, which would put the burden of excess spending on states for Medicaid, higher education, social services, infrastructure, etc.

¹Bloomberg Barclays Municipal Bond Index as of 5/24/17

Federal policy risk remains high for municipal bonds, particularly surrounding ACA reform/repeal and Medicaid funding. The muni market's current rich valuations and low volatility have been primarily technically driven and are pricing in a very low probability of any tax, healthcare, and fiscal policy reform coming out of D.C. Even if the Trump Administration is unsuccessful in implementing any reforms, the upside performance is limited at this point for the healthcare sector and for states heavily reliant on federal funding, as we believe cuts to Medicaid are highly likely.

The assertions in this perspective are Seix Investment Advisors' opinion.

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