CHIEF INVESTMENT OFFICE

Fixed Income Strategy

Munis Outperforming Other Bond Sectors So Far this Year

May 2021

SUMMARY

- Municipal bonds have been one of the best performing high-quality fixed income sectors this year, up 0.68% year-to-date[1], while most other high-quality sectors are in the red.
- Certain muni sectors have become extremely rich versus Treasurys, in some cases, unsustainably so, in our view.
- Muni outperformance has been driven by very strong retail demand for tax-exempt paper (given expected tax rate hikes), limited tax-exempt supply, and improving fundamentals.
- Lower-quality munis have outperformed higher quality, as credit spreads have tightened to near or below pre-pandemic levels.
- Credit quality is being boosted by the reopening of the national economy, from our point of view, as well as generous fiscal stimulus to states, local governments and other municipal issuers.
- We believe most munis still provide an advantage over Treasurys for tax-sensitive investors, particularly those in the lower-quality tiers, which may continue to outperform marginally.

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New Fixed Income Asset Allocation Tables and Commentary—see page 2

Listen to the audio cast

View the CIO Viewpoint

View the CIO Asset Allocation Guidelines

[1] Bloomberg Barclays U.S Municipal Index. Past performance is no guarantee of future results. It is not possible to invest directly in an index. See index definitions on page 8.

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FIXED INCOME ASSET ALLOCATION AND COMMENTARY

Low Tax Sensitivity

	All Fixed Income	
Asset Class	Strategic Target	Tactical Target
U.S. Government	28%	23%
U.S. Mortgages	24%	28%
U.S. Corporates	25%	30%
U.S. High Yield	6%	5%
International Fixed Income	15%	12%
Cash	2%	2%

Source: Chief Investment Office. Data as of April 30, 2021.

High Tax Sensitivity

	All Fixed Income	
Asset Class	Strategic Target	Tactical Target
U.S. Government	0%	0%
U.S. Mortgages	0%	0%
U.S. Corporates	7%	8%
U.S. High Yield	9%	8%
U.S. Inv Grade Tax Exempt	60%	63%
U.S. High Yield Tax Exempt	9%	7%
International Fixed Income	13%	11%
Cash	2%	3%

Source: Chief Investment Office. Data as of April 30, 2021.

Maturity Allocation

Maturity	Percent of Market Value (%)
U.S. Taxable FI Short Term 1-5 Yr	52
U.S. Taxable FI Intermediate Term 5-15 Yr	29
U.S. Taxable FI Long Term 15 Yr+	19
Total	**100**

Source: Chief Investment Office as of April 30, 2021.
Fixed Income by Sector based on CIO Strategic and Tactical Asset Allocation.

Fixed Income U.S. Rates Forecast

(% end of period)	4Q20*	2Q21	4Q21
Fed Funds Range	0.00-0.25	0.00-0.25	0.00-0.25
3-month LIBOR	0.24	0.15	0.20
2-Year T-Note	0.12	0.12	0.20
5-Year T-Note	0.36	0.55	0.75
10-Year T-Note	0.91	1.30	1.75
30-Year T-Bond	1.64	2.00	2.60

Source: BofA Global Research U.S. Rates Research; May 14, 2021. * Actual.
Note: Federal funds rate forecasts are modal expectations; other values are for market rates. The forecasts in the table above are the baseline view from BofA Global Research team. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts.
Past performance is no guarantee of future results. **There can be no assurance that the forecasts will be achieved. Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment performance.**

Sector Commentary and Positioning Considerations

- Bonds provide portfolio diversification, income and stability. Below-benchmark duration is recommended, as rates are rising off extremely low levels, and fiscal and monetary policies are supportive of higher inflation over the medium term.
- Yields are still slightly expensive in a global context relative to inflation though not nearly as bad as last year. Some allocation to Treasurys for liquidity and principal preservation is still advised, as Treasurys continue to provide one of the best short-term diversification benefits for equities among fixed income assets.
- We remain neutral on agency mortgage-backed securities (MBS). Technical factors for the sector remain supportive and the Federal Reserve (Fed) is expected to continue $40 billion of MBS purchases per month. Recent rates selloff, relatively tight MBS spreads and rapid duration extension have caused volatility to pick up and have brought future performance into question. At the same time, refinancing risk fell dramatically (a positive technical), and pressure from additional hedging needs remains contained. Despite tight valuations, we expect MBS to outperform Treasurys and recommend conservative positioning in shorter-duration assets.
- Credit spreads have stabilized around +90 basis points. With the Fed's commitment to markets, improving growth and earnings outlooks, and yields well above Treasurys, spread product should provide modest positive excess return over the medium term. Better relative value opportunities are available in select BBB-rated Industrials and U.S. Financials. The front end is less compelling given the compression in yields and spreads. Higher Treasury yields a headwind for total return but should be manageable.
- High yield (HY) valuations present mediocre absolute long-term returns after estimating credit losses. CCC-rated issues in particular are getting extremely expensive. Fundamentals will likely be challenged near term due to economic uncertainty. Near-term performance may be reasonable; however, given where the economy is in the business cycle, we don't view the risk/reward favorably. Any additions to HY risk need to have a very long time-frame. Within HY, we prefer more floating-rate loan exposure versus HY unsecured, with an allocation to both.
- In Municipals, valuations of high-quality munis versus Treasurys remain quite rich from a historical perspective but may be justified given fiscal stimulus, improving fundamentals, strong technicals, and expected tax increases. Credit spreads are expected to continue tightening, possibly through pre-pandemic levels, which would be a tailwind for low investment grade munis.
- HY muni credit spreads are still wide of pre-coronavirus levels but should continue tightening with improving fundamentals, expected additional fiscal stimulus and strong technical conditions.
- Compressed yields and risk premiums around the globe compared to the U.S., combined with potentially higher volatility in non-U.S. markets, present unfavorable risk/ reward conditions for non-U.S. fixed income, justifying an underweight position.

Yield Curve Commentary and Positioning

- We remain underweight duration. There is limited rate downside as monetary and fiscal policy is supportive of reflation, and additional curve steepening is possible.

Municipal bonds have been one of the best performing high-quality fixed income sectors this year, up 0.68% year-to-date. Most other high-quality sectors are in the red—the Bloomberg Barclays Aggregate, Treasury, Corporate, and MBS indices were down -2.3%, -3.3%, -3.1%, and -0.6%, respectively, over the same period. The strongest muni returns were in the lower credit quality tiers. **With extremely rich valuations in the highest-quality municipal bonds, lower-quality munis are likely to continue to outperform higher quality for the rest of the year, in our opinion.**

Exhibit 1: Returns for Major Fixed Income Indices

Bloomberg Barclays Index Returns (%)	April	1Q2021	YTD
Municipal Bond Index	0.84	-0.35	0.68
U.S. Treasury Index	0.75	-4.25	-3.25
U.S. Corporate Index	1.11	-4.65	-3.10
U.S. MBS Index	0.55	-1.10	-0.55
U.S. Aggregate Index	0.79	-3.37	-2.34

Municipal Index Returns by Rating (%)	April	1Q2021	YTD
AAA	0.74	-0.90	-0.01
AA	0.75	-0.65	0.26
A	0.94	0.06	1.24
BAA	1.26	1.28	2.79

Sources Bloomberg, as of May 7, 2021. Past performance is no guarantee of future results. Performance results are extremely short term and do not provide an adequate basis for evaluating performance potential over varying market conditions or economic cycles. Investment results may have been different had another time period been chosen for this example. It is not possible to invest directly in an index. See index definitions on page 8.

Muni outperformance has been driven by very favorable technicals and improving fundamentals.

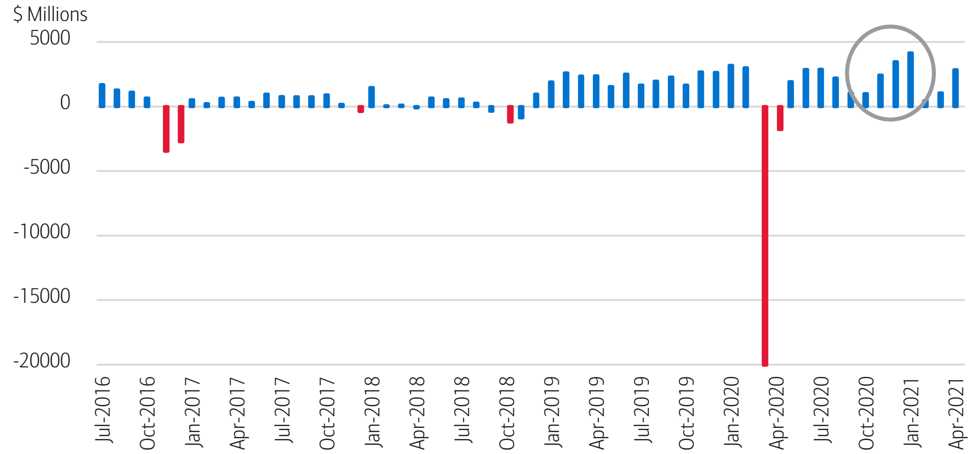
- Demand for tax-exempt paper strengthened after Election Day 2020 and accelerated after the Senate runoffs in January, with expectations of rising tax rates. Municipal bond fund flows from January through April 2021 were the strongest start to a year on record, according to Investment Company Institute.
- Supply has been limited, with January-April 2021 new issue volume up only 0.4% from the average corresponding periods in 2015–2019. However, this could change if Congress restores tax-exempt advance refundings or authorizes interest-subsidized taxable munis, akin to the January 2020 Build America Bonds.
- Government finances are improving as the economy reopens, from our point of view. State and local government tax revenues were actually up in 2020, despite significant shortfalls in the second quarter.
- The American Rescue Plan Act of 2021 provided generous fiscal stimulus to states, local governments and municipal issuers in the education, transportation and hospital sectors, which helped to further boost credit quality.

Demand

Demand for munis strengthened on expectations of higher tax rates after President Joe Biden's election in November 2020, and grew even stronger after the January 2021 Senate runoff elections, in which the Democratic Party gained control of both chambers of Congress. As a result, municipal bond mutual funds and exchange-traded funds (ETFs)—which hold $1.05 trillion of municipal securities, or a significant 26.7% of all municipal bonds outstanding[2]—saw flows increase markedly from November 2020 to January 2021. Through April 28, year-to-date municipal bond mutual fund and ETF inflows totaled $43.3 billion, *the strongest four-month start to a year, on record.*

[2] As of December 31, 2020. Source: Federal Reserve, Financial Accounts of the United States.

Exhibit 2: Municipal Bond Mutual Fund and ETF Flows



Source: Investment Company Institute, as of May 7, 2021.

The market's expectations of higher tax rates were validated with the release of President Biden's American Families Plan (AFP) on April 28. It proposed an increase in the top federal income tax rate from 37% to 39.6%, identical to candidate Biden's campaign platform. Given the existing 3.8% Medicare surtax, this would be a combined 43.4% marginal tax rate on investment income. Higher tax rates generally support higher tax-exempt muni valuations, all else equal.

Of course, the AFP is just a proposal; Congress must vote on any tax package, and the final bill will no doubt have a number of differences from the president's tax plan. However, the 39.6% top tax rate is likely to survive, in our opinion. Other potential revisions to the tax code pertaining to munis are also possible. For example, while not mentioned in the AFP, we believe there will be a push to repeal the $10,000 cap on state and local tax (SALT) deductions. Doing so could marginally decrease the relative attractiveness of in-state municipal bonds for taxpayers in high-tax jurisdictions.

Supply

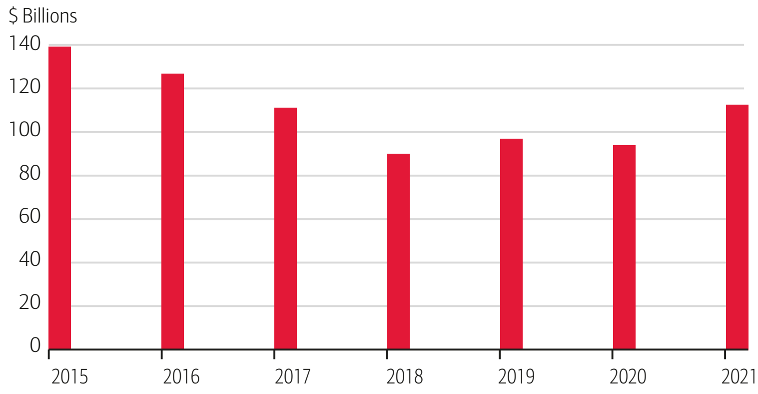
Supply for tax-exempt paper has been limited since 2018, as tax-exempt advance refundings were eliminated with the Tax Cuts and Jobs Act of 2017. As a result, the volume of tax-exempt bonds issued in 2018-2020 was *lower* than it was in the prior three years from 2015-2017. However, taxable munis emerged as a growing asset class in 2019, as issuers found that they could still realize savings by refunding tax-exempt bonds with taxable munis in an extremely low-rate environment.

Tax-exempt volume for January–April 2021 was $106.3 billion, up 21% from last year, but that comparison is distorted by the unusually low issuance levels in March and April 2020 due to the initial coronavirus outbreak. January-April 2021 new issue volume was up just 0.4% compared to the average corresponding periods from 2015-2019. Recently, with the rise in taxable yields, we have seen an increase in issuers selling forward-delivery tax-exempt refunding bonds (i.e., with settlement dates well beyond the typical settlement period), as issuers chose to try to lock in current tax-exempt rates to refinance outstanding munis not yet otherwise eligible to be refunded on a tax-exempt basis.

It is possible tax-exempt advance refundings will be restored by Congress this year, which would increase the volume of tax-exempt refunding bonds. However, it is also possible that interest-subsidized taxable municipal bonds—akin to Build America Bonds (BABs) issued in 2009-2010—may be authorized as part of an infrastructure bill later this year; this could potentially dismantle the supply of new money tax-exempt munis, in our opinion.

Exhibit 3: Municipal Bond Issuance

Exhibit 4: Year-to-Date Tax Exempt Issuance



Source: Bloomberg, as of May 7, 2021.

Credit Quality on a Stable-to-Improving Trend

We had a more favorable view than some of the more pessimistic investors on municipal credit last year and had argued against the expectation of massive credit rating downgrades in 2020. State and local government finances held up much better than the market initially feared, when 2Q 2020 state and local government tax revenues declined -19.4%, year-over-year. However, this was mainly because tax return deadlines were extended from April to July 2020. Tax revenues rebounded strongly in 3Q 2020, and for the full year were actually *up* 1.9% from 2019. Furthermore, the trend is improving; 4Q 2020 state and local government tax revenues grew 6.1% over 4Q 2019. Revenues in sectors that had been under pressure last year, such as higher education and transportation, are also rebounding as the nation's economy opens up.

Exhibit 5: Non-Seasonally Adjusted State and Local Government Tax Revenues

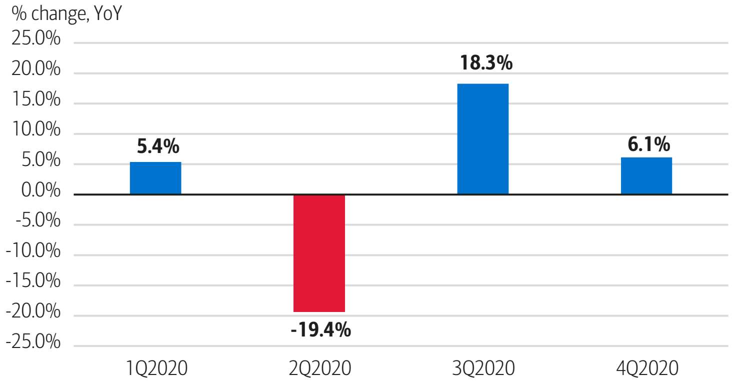
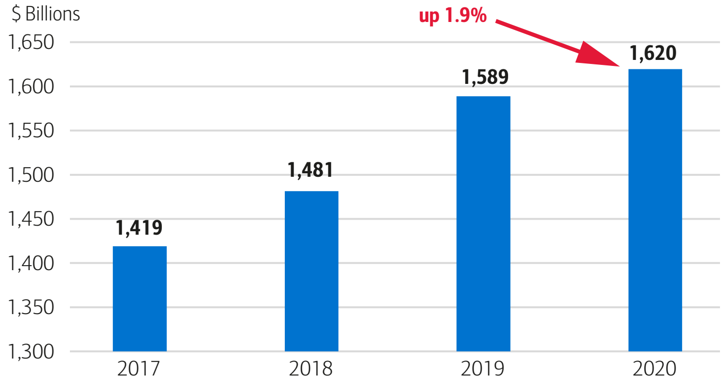


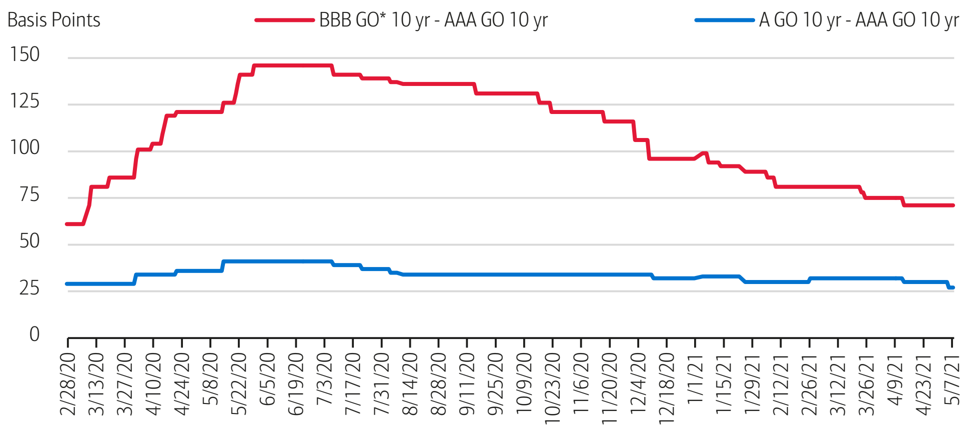
Exhibit 6: Non-Seasonally Adjusted State and Local Government Tax Revenues



Source: U.S. Census Bureau, as of May 7, 2021.

In addition to strengthening tax revenues, the recently enacted American Rescue Plan Act of 2021 provided $350 billion to states and local governments and over $200 billion to municipal issuers in the education, transportation and hospital sectors. The combination of fiscal stimulus and improving tax and user fee revenues drove credit spreads tighter; the BBB-to-AAA muni credit spread has recovered 88% of its widening from last spring, and the single-A spread is now 2 basis points *tighter* than it was at the end of February 2020. We believe municipal credit is improving and expect credit spreads to tighten further over the coming months. In addition, credit rating agencies have upgraded their outlooks on a number of large municipal issuers as well as various sectors that had been under pressure last year, such as states, local governments, airports, transit and higher education.

Exhibit 7: Municipal Credit Spreads



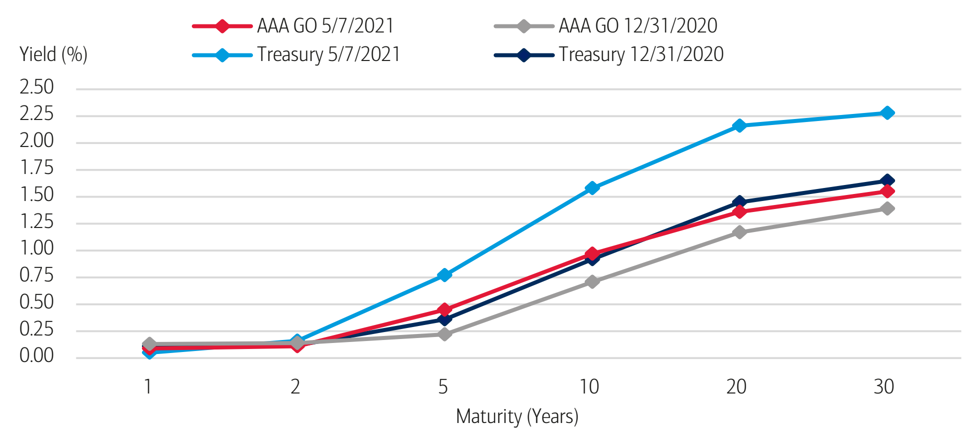
Source: TM3, as of May 7, 2021. *GO = general obligation.

Rich Valuations May Limit Future Muni Outperformance

We typically monitor muni valuations by comparing muni yields to comparable-maturity Treasury yields, the "Muni-to-Treasury yield ratio." Yields on the highest quality (AAA) municipal bonds are generally lower than the pre-tax yields of similar-maturity Treasurys, since munis are exempt from federal taxes, leading to ratios below 100%.

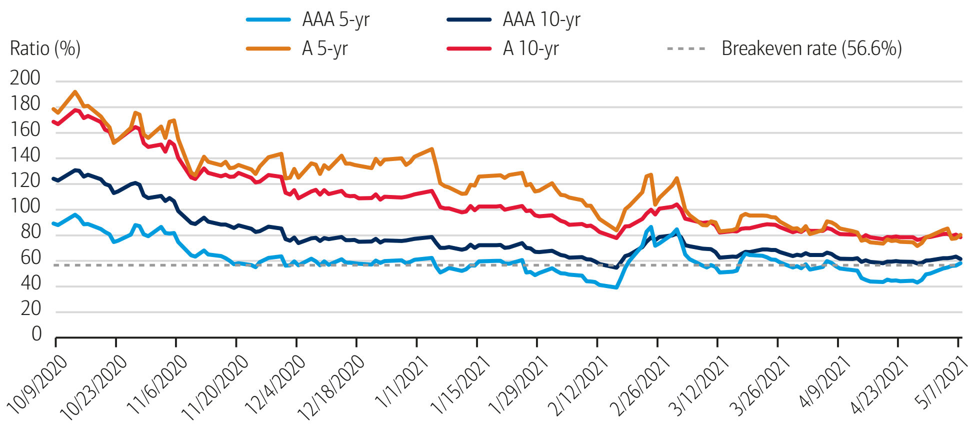
Given the current very favorable technical and fundamental backdrop, muni yields have risen and steepened much less than Treasurys thus far this year, causing muni valuations to richen to historic levels. *In some instances, munis are actually more expensive than Treasurys on an after-tax basis, which is highly unusual.* For example, if the highest marginal federal tax rate is raised to 43.4% [39.6% income tax + 3.8% Medicare surtax], then as long as munis yield more than 56.6% of Treasurys, they would earn more than Treasurys on an after-tax basis, assuming no credit losses. However, since recent demand for tax-exempt munis has greatly outpaced supply—particularly due to mutual funds and ETFs that can buy only tax-exempt paper—some muni-to-Treasury yield ratios have fallen below this breakeven rate, an effective valuation "floor." **In our opinion, such extremely rich valuations are unsustainable. This may limit future 2021 muni outperformance, particularly for the highest-quality municipal bonds.**

Exhibit 8: Muni Yields Have Bear-Steepened this Year, but Less than Treasurys



Source: TM3, as of May 7, 2021.

Exhibit 9: Muni-to-Treasury Yield Ratios Fall to Historically Low Levels



Source: TM3, as of May 7, 2021. Past performance is no guarantee of future results. Performance results are extremely short term and do not provide an adequate basis for evaluating performance potential over varying market conditions or economic cycles. Investment results may have been different had another time period been chosen for this example.

CONCLUSION

Munis have outperformed most other fixed-income sectors thus far this year, particularly in the lower-quality tiers. Valuations have richened to historic levels due to strong technicals and improving fundamentals. We believe most munis still provide an advantage over Treasurys for tax-sensitive investors, particularly those in the lower-quality tiers, which may continue to outperform marginally. We expect continued credit improvement in the municipal sectors that were most adversely affected by coronavirus-related shutdowns last year. We would, however, be very cautious longer term on any municipals that are trading richer than Treasurys on an after-tax basis; this is an unsustainable level that will correct at some point, in our opinion. If that occurs during a period of rising rates, those bonds may then face significant negative absolute and relative declines versus Treasurys.

Asset Class Proxies

See below for index definitions.

Asset Class	Index
U.S. Investment Grade	Bloomberg Barclays U.S. Corporate Bond Index
Emerging Mkts	Bloomberg Barclays EM USD Aggregate Total Return Index
U.S. Treasury	Bloomberg Barclays U.S. Treasury Index
U.S. Mortgage-Backed Securities (MBS)	Bloomberg Barclays U.S. Mortgage Backed Securities Index
U.S. Asset-Backed Securities (ABS)	Bloomberg Barclays Capital Asset-Backed Index
U.S. Commercial Mortgage-Backed Securities (CMBS)	Bloomberg Barclays U.S. CMBS Index
U.S. Corporate	Bloomberg Barclays U.S. Corporate Bond Index
U.S. High Yield	Bloomberg Barclays High Yield Corporate Bond Index
U.S. Leveraged Loans	S&P/LSTA Leveraged Loan Index
U.S. Municipals	Bloomberg Barclays U.S. Municipal Index
U.S. Municipal High Yield	Bloomberg Barclays High Yield Municipal Index

Index Definitions

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index.

Indexes are all based in dollars.

ICE BofA U.S. Corporate Index tracks the performance of U.S. dollar-denominated Investment Grade corporate public debt issued in the U.S. domestic bond market. Qualifying bonds must have at least one year remaining term to maturity, a fixed coupon schedule and a minimum amount outstanding of $150 million. Bonds must be rated Investment Grade based on a composite of Moody's and S&P.

ICE BofA Fixed Rate Preferred Securities Index tracks the performance of fixed rate U.S. dollar denominated preferred securities issued in the U.S. domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and must have an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofA U.S. Capital Securities Index is a subset of ICE BofA U.S. Corporate Index including securities with deferrable coupons.

ICE BofA U.S. High Yield Index tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market. Bonds must be rated below investment grade based on a composite of Moody's, S&P and Fitch.

ICE BofA U.S. Treasury & Agency Index tracks the performance of U.S. dollar denominated U.S. Treasury and non-subordinated U.S. agency debt issued in the U.S. domestic market.

ICE BofA U.S. 3-Month Treasury Bill Index. The issue selected at each month-end rebalancing is the outstanding Treasury Bill that matures closest to, but not beyond, three months from the rebalancing date. To qualify for selection, an issue must have settled on or before the month-end rebalancing date. While the index will often hold the Treasury Bill issued at the most recent 3-month auction, it is also possible for a seasoned 6-month Bill to be selected.

Fed Funds Rate data is released by the NY Federal Reserve each day at approximately 9:00 a.m. EST for the prior business day. Until March 1, 2016, the daily effective federal funds rate was calculated by the New York Fed as a volume-weighted mean of overnight rates on trades arranged by major brokers. As of March 1, 2016, the New York Fed is reporting the daily volume-weighted median value of trades provided by the brokers.

Bloomberg Barclays EM USD Aggregate Total Return Index. The Bloomberg Barclays Emerging Markets Hard Currency Aggregate Index is a flagship hard currency Emerging Markets debt benchmark that includes USD-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers.

Bloomberg Barclays U.S. Treasury Index tracks the market for Treasurys issued by the U.S. government. It represents the U.S. Treasury component of the U.S. Government index. An investment cannot be made directly in a market index.

Bloomberg Barclays U.S. Mortgage Backed Securities (MBS) Index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Bloomberg Barclays Capital Asset-Backed Index is composed of debt securities backed by credit card, auto and home equity loans that are rated investment grade or higher by Moody's Investors Service, Standard & Poor's Ratings Service or Fitch Investor's Service.

Bloomberg Barclays U.S. CMBS Index is the Bloomberg Barclays Non-Agency Investment Grade CMBS: BBB Total Return Index Unhedged.

Bloomberg Barclays Investment Grade Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes U.S. dollar-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers. The U.S. Corporate Index is a component of the U.S. Credit and U.S. Aggregate Indices.

Bloomberg Barclays High Yield Corporate Bond Index measures U.S. dollar denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt.

Bloomberg Barclays Floating Rate Notes Index: <5 Years Index consists of debt instruments that pay a variable coupon rate, a majority of which are based on the 3-month LIBOR, with a fixed spread. The Index may include U.S. registered, dollar denominated bonds of non-U.S. corporations, governments and supranational entities.

S&P 500 Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. The index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities.

S&P 500 Total Return Index is calculated intraday by S&P based on the price changes and reinvested dividends of the S&P 500 Index with a starting date of Jan 4, 1988.

S&P/LSTA Leveraged Loan Index is a market value-weighted index designed to measure the performance of the U.S. leveraged loan market based upon market weightings, spreads and interest payments.

Bloomberg Barclays U.S. Municipal Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

Bloomberg Barclays High Yield Municipal Index is a benchmark that covers the high yield portion of the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

Bloomberg Barclays Global Treasury Index tracks fixed-rate, local currency government debt of investment grade countries, including both developed and emerging markets. The index represents the treasury sector of the Global Aggregate Index and contains issues from 37 countries denominated in 24 currencies.

Bloomberg Barclays U.S. Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented.

Glossary

Breakeven Rate—The rate at which the after-tax yield on a Treasury security and a municipal security would be equal for a taxpayer in the highest income tax bracket.

Duration—Duration typically measures the sensitivity of the value of a bond or fixed income portfolio to changes in interest rates. In general, the higher the duration, the more a bond's price will drop as interest rates rise and thus the greater the interest rate risk.

Yield to Worst—The yield to worst is the lowest potential yield that can be received on a bond without the issuer actually defaulting.

Important Disclosures