TAX-EXEMPT MARKET COMMENTARY

TREASURY & MUNICIPAL BOND MARKET

Week Ending January 5th, 2018

MUNICIPAL BOND MARKET:

- The month of ***December was one for the record books*** as total supply for the month topped $56 billion, eclipsing the 1985 record of $54 billion.
- Overall municipal ***rates dropped again in the year 2017*** for most of the benchmark fixed-rate maturities

  Approximate "AAA" rate changes Jan. 4th to Dec. 29th, 2017
  - 5-Year (2022 maturity): -9 bps
  - 10-Year (2027 maturity): -32 bps
  - 20-Year (2037 maturity): -47 bps
  - 30-Year (2047 maturity): -49 bps
- Many Issuers who were able to put off issuing bonds in December eagerly await the start of 2018, where ***indications for January supply appear to be meager at best***. This puts issuers and traders offering bonds in a strong position with limited options for investors to choose.
- Additionally, ***January is one of the largest reinvestment periods*** due to the commonality of Jan 1st/15th coupon payments and maturing principle dates.
  - Bloomberg estimates approximately $18.3 billion in redeemed principle for the month of January, well in excess of the expected new issue supply.
- Partially offsetting the strong supply/demand setup for municipal bonds is the limit of ***how low tax-exempt to taxable ratios can move before investors reduce municipal demand.***
  - We are currently trading near the strongest ratio levels of the past year and with tax reform adding uncertainty for bank/insurance company demand, it appears municipal bonds may be near short-term "topped out" levels without an improvement in Treasuries or another municipal specific event.

GENERAL MARKET:

- ***Treasury notes and bonds started the year off under pressure*** as investors continued to focus investment in stocks, with the major stock indexes continuing their run of record high closings.
- The rate changes for U.S. Treasuries over 2017 highlight the yield curve flattening driven by the Fed raising short-term rates and investors buying long maturities.

  U.S. Treasury rate changes Jan. 4th to Dec. 29th, 2017
  - 5-Year: +27.9 bps
  - 10-Year: -3.9 bps
  - 30-Year : -32.6 bps
- The last 2017 jobs report was released Friday and showed weaker-than-expected growth in December with the economy adding 148,000 jobs versus a 190,000 expectation.

THE WEEK AHEAD:

- The first meaningful supply week of 2018 shows the expected slow start to issuance with approximately $4.2 billion scheduled, about half the average week of 2017.
- The last economic reports of 2017 will continue, with PPI (Thurs), CPI and Retail Sales (Friday).

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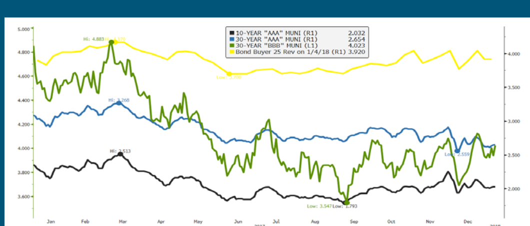
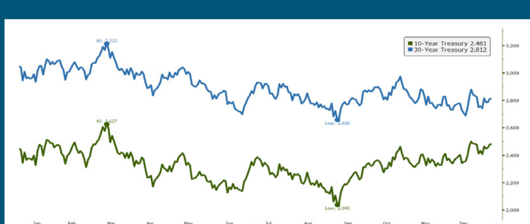
MARKET DATA RESULTS:

Week Ending	January 5th, 2018	1-Week Change
10-YR "AAA" BVAL	2.012%	+2.1 BPS
30-YR "AAA" BVAL	2.575%	+3.2 BPS
30-YR "BBB" BVAL	3.984%	+11.7 BPS
30-YR "A1" B.B. Rev.	3.92%	Unchanged
10-YR Treasury	2.477%	+7.1 BPS
30-YR Treasury	2.811%	+7.1 BPS





TAX-EXEMPT MARKET COMMENTARY

MUNICIPAL BOND SHORT TERM MARKET

Week Ending January 5th, 2018

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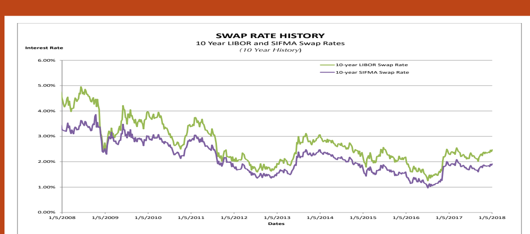
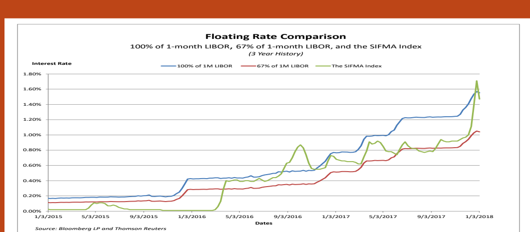
WEEKLY CHANGE:

Week Ending	January 5th, 2018	1-Week Change
SIMFA	1.47%	-24BPS
1-MTH LIBOR	1.55%	-1BP
3-MTH LIBOR	1.70%	+1 BP
2-YR LIBOR SWAP	2.15%	+7 BPS
10-YR LIBOR SWAP	2.47%	+7 BPS
30-YR LIBOR SWAP	2.61%	+7 BPS

2017 SUMMARY:

Week Ending	December 29, 2017	December 30,2016	Annual Change
SIMFA	1.71%	0.72%	+99 BPS
1-MTH LIBOR	1.56%	0.77%	+79 BPS
3-MTH LIBOR	1.69%	1.00%	+69 BPS
2-YR LIBOR SWAP	2.08%	1.45%	+63 BPS
10-YR LIBOR SWAP	2.40%	2.34%	+6 BPS
30-YR LIBOR SWAP	2.54%	2.59%	-5 BPS





MUNICIPAL BOND SHORT TERM MARKET:

- The SIFMA Index ***reset at 1.47%***, down 24 basis points week over week after being up 60 basis points over the previous two weeks.
  - –Assets at tax-exempt money market funds were ***up $2.8 billion to $134 billion.***
  - –The SIFMA Index is now ***95% of one-month LIBOR after being 109% last week.***
- The Fed was the biggest story for the short-term market in 2017 as it ***raised its target rate 0.25% on three separate occasions for a total increase of 0.75%.***
  - –While these increases were not a departure from Fed speak, many market participants were skeptical based on its prior history and stagnant inflation and wages.
  - ***–The Fed is pointing to three 2018 rate hikes but as with 2017, markets are skeptical.***
- ***Tax reform highlighted the political accomplishments of 2017 dramatically lowering corporate tax rates and incentivizing repatriation of funds held outside the U.S.*** Updates to the personal tax code were met with mixed reactions as lower marginal tax rates were offset by the removal of some widely used deductions.
  - ***–Private activity bonds remained unscathed after concerns non-profits might lose the ability to issue tax-exempt debt. As was anticipated, tax-exempt advanced refundings will no longer be allowed under the new rules.***
  - –The lowering of the corporate tax rate could have a negative effect on municipal bonds as the benefit to holding tax-exempt debt for corporations is reduced.
  - –We will continue to keep you updated on the impact to the municipal debt market and its participants throughout 2018.
- The 0.75% increase to the Fed's target rate sent the front end of the LIBOR swap curve higher in 2017. The long end of the curve continued to find strength which resulted in a substantial curve flattening.
  - –The 2-year LIBOR swap rate was ***up 63 basis points*** while the 10-year LIBOR swap rate was up ***only 6 basis points.***
- The most active institutions providing ***new or replacement letters of credit*** or liquidity facilities last year included ***Bank of America, Barclays Bank Plc, Bank of Tokyo Mitsubishi, Citibank, JP Morgan Chase, PNC Bank, Royal Bank of Canada, Sumitomo Mitsui Banking Corp, TD Bank and Wells Fargo.***
- Legal entity identifier—borrowers with existing interest rate swaps ***should have obtained a GMEI*** from gmeiutility.org.
  - –Entering into new swaps, terminating or modifying swaps will also require that borrowers and issuers ***obtain a GMEI through gmeiutility.org.***
- Clients should expect that, prior to entering into new swaps, terminating or modifying existing swaps, swap dealers will ***require that they either adhere to ISDA Protocols*** 1.0 and 2.0 or ***enter letter agreements*** that cover the same topics: CFTC Business Conduct Standards, eligible contract participant category, End-user Exception from clearing requirements, and documentation, valuation and reconciliation matters.

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