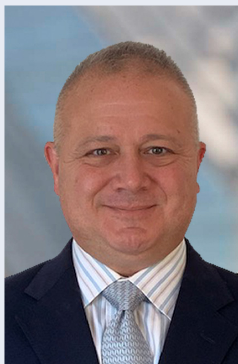
Portfolio Commentary

Navigator® Tax-Free Fixed Income

Portfolio Managers



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A Tale of Two Markets

Market Review

Municipal bonds outpaced U.S. Treasuries during the first quarter 2021 as record inflows into the asset class continued to outpace moderate supply. Fiscal stimulus and higher expectations for a rapid economic recovery combined with strong vaccine momentum to push the 10-year U.S. Treasury yield higher by a whopping 82 basis points.

The 10-year U.S. Treasury finished the first quarter yielding 1.74% on March 31st as U.S. Treasuries experienced one of the worst performing quarters since 1980 according to Bloomberg. Fiscal and monetary headlines continued to dominate news flow in the first quarter.

Monetarily, global central bank liquidity was viewed as a sizeable tailwind for risk assets as the Fed continued to increase its balance sheet and provided cautious communication regarding any slowdown in asset purchases for the foreseeable future. Fiscally, one of biggest headlines during the quarter was the passing of the $1.9 trillion coronavirus relief package, with over $350 billion earmarked for state and local aid, which will directly benefit municipal credits.

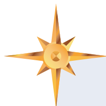
Investors, fearing the likelihood of an increased tax rate, continued to flock to the muni asset class in a hunt for tax-exempt yield. According to ICI, munis experienced another quarter of positive fund flows, totaling over $24.7 million (as of 03/24/2021), continuing a trend that started during the first quarter of 2020. This steady demand compressed muni ratios as the 10-year AAA muni-to-Treasury ratio decreased from 75% at the start of the quarter to 62% by the end of March.

During the quarter, Navigator® Tax-Free Fixed Income investors enjoyed another period of positive performance relative to the Bloomberg Barclays Municipal Bond 5 Year Total Return Index, which returned -0.31%.

First Quarter Performance Highlights

- Allocations to local general obligation bonds (GOs) and pre-refunded bonds were marginally reduced in favor of water and sewer revenue bonds, education, county level lease backed bonds issued for "bricks and mortar" projects (police stations, etc.), industry development revenue (IDR)/pollution control revenue (PCR), and resource recovery bonds.
- Healthcare exposure remained virtually unchanged at 5.46%, as did transportation (7.01%) and power bonds (3.08%).
- Exposure to state level GOs continued, mainly in Connecticut, California, New York, Pennsylvania and New Jersey. These exposures were increased based on high tax states making hard financial decisions pre- and post-COVID, the passage of massive COVID related direct aide and general austerity measures. In the case of Connecticut, our exposure increased 8x to approximately 0.93% of our holdings over the past 6 months.

Past performance is not indicative of future results.
This is not a recommendation to buy or sell a particular security. Please see attached disclosures.



- Cash in the portfolio remained nearly unchanged at 6.77%, and we reduced exposure in AAA credit in lieu of marginal increases in A and BBB rated paper. Economic fundamentals, technicals, and spreads all supported buying wider credits early in the quarter. Muni spreads were at their widest ranges to AAA not seen in over two years. Continued purchases are still supported by spreads in our current target maturities.

Positioning and Outlook

The first quarter of 2021 was a tale of two markets. Through February 11, as usual after a Democratic win, munis thrived—the curve parallel shifted downward in yield, and ratios to Treasury bonds reached new lows (53% 3-year, 41% 5-year, 58% 10-year and 72% 30-year).

Mid-February proved to be a turning point as inflation fears combined with a doubling in 30-day supply, which forced tax exempt yields and their attendant ratios to treasury bonds higher. From February 11 to March 31, short-term tax exempt yields increased approximately 14 basis points, while long-term yields increased in excess of 40 basis points. The bulk of the muni curve's steepening occurred in the 3-7 year bucket.

Second half performance during the quarter vindicated the preparation we started at the end of 2020 for a materially steeper curve, as the average maturity was decreased 13% earlier in the period. From the start of Q4 in 2020, duration was reduced 8.5% and held static through the quarter. As the major municipal bond pricing services make their evaluations by painting with a broad, unscientific brush, performance of some of our longer cushion bonds disap¬pointed as evaluations favored the final maturity versus the shorter duration created by the embedded call.

Economic aid, increased taxes, and current supply levels should buoy municipals into Q2 to some extent. Further, the quarter brings us that much closer to the positive technicals that early summer usually brings. We are still anticipating bear steepening, which could be followed by bear flattening next year should the Fed alter their short-term rate management. The 10 to 15-year maturities are often a fulcrum on which the curve pivots: we will focus there and manage duration via structure.

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The Bloomberg Barclays U.S. Municipal Index covers 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 prerefunded bonds.

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