The municipal bond opportunity

November 30, 2022

- Municipal bonds can offer attractive taxable equivalent returns.
- We believe municipal bonds offer an attractive risk/return balance for investors.
- While elevated inflation and a slowing economy present challenges, state and local finances are strong, as are municipal credit fundamentals.

Recent historic volatility in bond markets has been broad-based. Municipal bond total returns, while also negative year-to-date in 2022 (the Bloomberg Municipal Index was -8.79% through 11/30/22), have fared somewhat better than many taxable sectors (the Bloomberg US Aggregate Bond Index, comprised of high quality sectors, was -12.84% through 11/30). With yields much higher and credits spreads within the municipal market wider as well, we believe municipals offer attractive near-term value for investors looking to initiate, re-enter or expand tax free bond holdings. Typically used as a conservative allocation for investors seeking income levels competitive with taxable fixed income, the municipal market currently offers several compelling components.

Valuation

Municipal yields are near their highest levels in over 10 years. The high inflation of 2022 has prompted the Fed to act aggressively, causing all bond yields to rise and depressing returns. That action has now created value going forward in high quality fixed income as we believe the Fed's terminal rate of this hiking cycle is mostly priced into the market. Inflation is expected to decline, suggesting today's yields may be near the top and creating opportunity for investors.

Municipal 10-Year Bond Yield

*Source: Bloomberg 10y AAA municipals.

High credit quality over the long term

The municipal market is an overwhelmingly high-quality bond market, with low historical default rates over a long horizon, including during recessions. High Grade bonds (AAA and AA rated) have near-zero default rates historically. Many state and local governments have enjoyed surging revenues from rising income tax and sales tax revenues as well as large federal transfers from the various Covid relief bills. Thus, high-quality governmental issuers are well positioned to weather a potential economic slowdown compared to other recessions, and the demand for municipal securities is expected to increase.

Municipal bonds offer attractive quality compared with corporates

10-year cumulative average default rates

Credit Rating	Municipal* 1986 2021	Corporate** 1981 2021
AAA	0.00%	0.83%
AA	0.03%	0.98%
A	0.08%	1.69%
BBB	0.73%	4.01%
BB	3.93%	13.69%
B	10.78%	25.66%
CCC-C	36.52%	56.48%

*Source: STANDARD&POOR'S RatingsDirect®

2021 Annual U.S. Public Finance Default and Rating Transition Study, May 11, 2022.

**Source: STANDARD&POOR'S RatingsDirect®

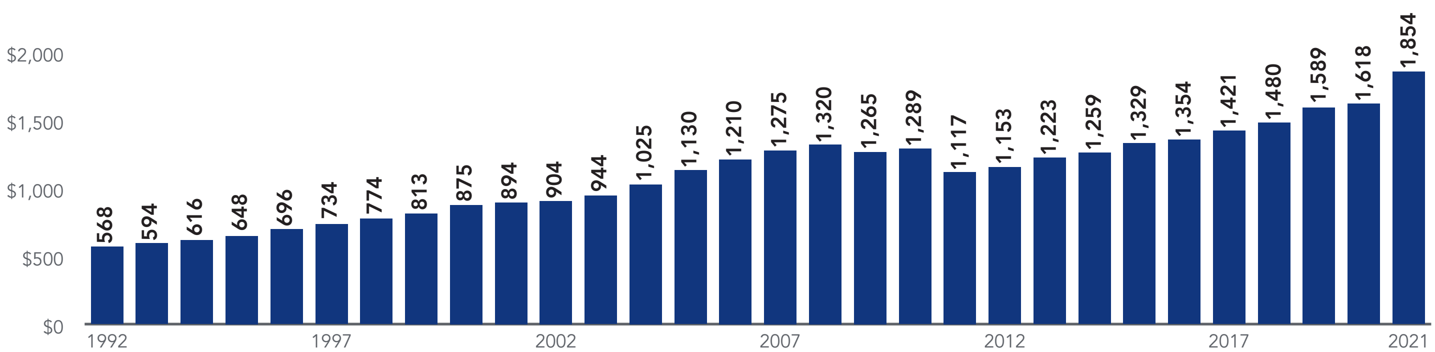
Default, Transition, and Recovery: 2021 Annual U.S. Corporate Default And Rating Transition Study ', July 25, 2022.

State tax and local revenues are at record levels

Local tax revenues—dominated by property taxes—are less sensitive to fluctuations in gross domestic product (GDP) and linked to property valuation and the varying rules surrounding property reassessment around the country. State and local tax receipts have nearly quadrupled over 30 years, growing at nearly double the inflation rate. We believe state and local governments are well positioned for a potential recession with very strong balance sheets and more cash than in prior recessionary periods, making municipals less vulnerable than corporate entities.

Municipalities are approaching 2 trillion in annual tax receipts

Annual summary of state & local tax receipts (billions)

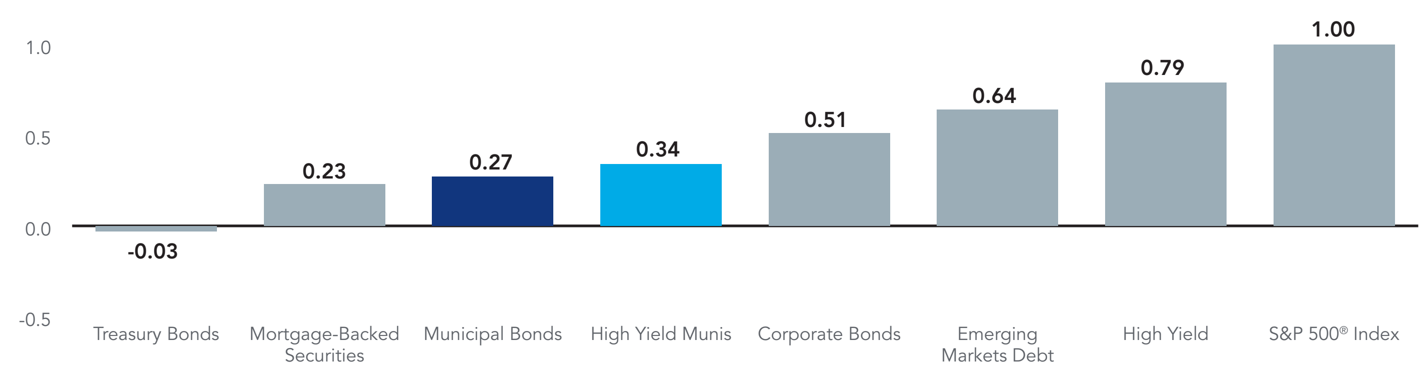


Source: U.S. Census Bureau

Favorable total return potential

In 2022, bond markets experienced rare historic losses. Large portions of the municipal market were issued at the prevailing low yields of the previous five years and refunding such debt will not be economically advantageous in the current environment, keeping supply low in the near future. We believe low supply amid rising demand from investors attracted to the highest absolute yields in over a decade suggests the municipal market may be poised for favorable total return. We also believe future returns will potentially be enhanced by slowing inflation and the prospect of recession, driving yields down and municipal prices higher, benefitting existing investors. Additionally, municipals have historically had lower return correlation to equity markets than other bond sectors.

10-year correlation to S&P 500®



Source: Bloomberg, as of 11/30/2022

The amount of public information available about municipal securities is generally less than that for corporate bonds. Special factors, such as legislative changes and local and business developments, may adversely affect the yield or value of municipal securities.

Credit ratings do not remove market risk.

Bond credit ratings measure the risk that a security will default. Credit ratings of A or better are considered to be high credit quality; credit ratings of BBB are good credit quality and the lowest category of investment grade; credit ratings of BB and below are lower-rated securities; and credit ratings of CCC or below have high default risk.

Views are as of November 30, 2022 and are subject to change based on market conditions and other factors.

This should not be construed as a recommendation regarding tax information.

Consult your tax professional for more information.

There is no guarantee that any specific investment approach will be successful.

Income from municipal securities may be subject to the federal alternative minimum tax and state and local taxes.

Bond prices are sensitive to changes in interest rates and a rise in interest rates can cause a decline in their prices.

High-yield, lower-rated securities generally entail greater market, credit/default and liquidity risks, and may be more volatile than investment grade securities.

Bloomberg US Aggregate Bond Index: Is an unmanaged index composed of securities from the Bloomberg Government/Corporate Bond Index, Mortgage-Backed Securities Index and the Asset-Backed Securities Index. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. Indices are rebalanced monthly by market capitalization.

Bloomberg US Municipal Bond Index is composed of USD denominated long-term tax exempt bonds.

Correlation measures the similarity between two return series on a scale of -1.0 to +1.0. Assets with a correlation of 1.0 are perfectly correlated, -1.0 demonstrates negative correlation and 0.0 indicates the absence of correlation.

Past performance is no guarantee of future results.

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Federated Securities Corp.