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<u>Second Quarter Fixed Income Letter to Clients</u>

Interest rates were volatile in the second quarter. The 10-year US Treasury yield advanced above 3% in mid-May which was the highest rate for the 10-year US Treasury since 2011. But the bond market has since recovered with growing geopolitical uncertainty. Rates fell back below 3% by late May and bonds have continued to strengthen throughout June.

Tax-free municipal bonds posted positive returns for the quarter resulting from the recent strength in the US Treasury market, along with a relief that any further tax changes that might impact the municipal bond market directly are off the table for now and unlikely to return until after the elections in November. Supply and demand dynamics are favorable for tax-exempt municipal bonds, and the economic environment remains supportive as well.

Our outlook for bonds over the next six to twelve months has changed slightly from last quarter's outlook. We feel that there is a 50% probability that the benchmark US Treasury 10-year bond yield will rise from today's 2.78%-2.98% range to around 3.20%-3.40%. We assign a 25% probability that the 10-year bond yield will simply remain in today's range. We feel there is a 15% likelihood that rates will run lower to the 2.50%-2.60% area. And given the general nature of markets we always feel that there is a 10% chance that yields will rise or fall much higher or lower than we or anyone can reasonably predict today due to "unknowns". As we stated last quarter, the key trigger guiding our outlook is inflation. Until wage pressures materialize more forcefully, Federal Reserve policy makers are unlikely to deviate from the course of three to four rate increases that they have laid out for this year.

Our current strategy for municipal-bond investors is to own a diversified portfolio of high-quality, investment grade bonds maturing in one to ten years. For clients who reside in high income tax states, we focus on buying a diversified portfolio of bonds issued in their state (when possible) in order to benefit from the state tax exemption. We also buy out-of-state bonds for the purpose of credit diversification.

Our client's portfolios are designed to earn the highest after-tax return while maintaining a relatively defensive portfolio structure given today's interest rate environment. Of course each client has a unique set of circumstances that we focus on in constructing the portfolio to meet their specific needs. Tax-free income, preservation of principal and targeted duration management is what makes a municipal bond portfolio an attractive investment for clients in a high tax bracket.

Evan Slater
Fixed Income Portfolio Manager