Municipal Fixed Income Commentary

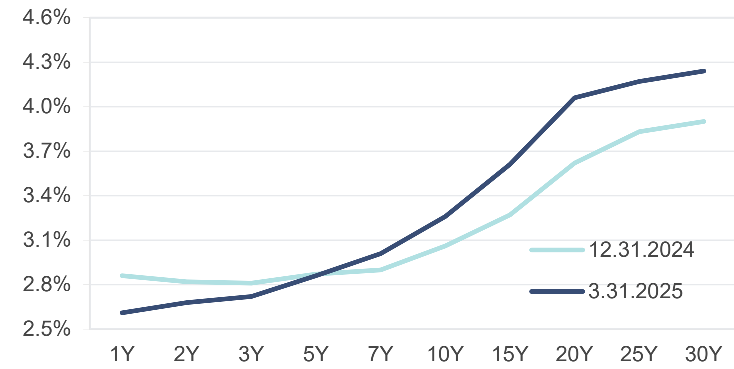
1st Quarter 2025

Despite beginning the year with favorable valuations and a strong technical environment, the municipal market delivered uneven performance under the weight of mounting fiscal policy and general economic uncertainty. The ICE BofA 1-10 Year Municipal Securities Index returned 0.62% for the quarter, with gains in January and February ultimately offset by a sharp decline in March (-0.75%). Investor sentiment weakened in March especially, driving negative excess return versus duration-matched Treasuries of -1.22% for the month and -1.52% for the quarter amid headline risks from tariffs, federal funding uncertainty, and a heavy new issue calendar. As a result, municipal-to-Treasury ratios ended the quarter at the highest levels in the past 12 months, finishing at 72% for the 5-year and 77% for the 10-year, closely aligned with longer-term averages for each measure.

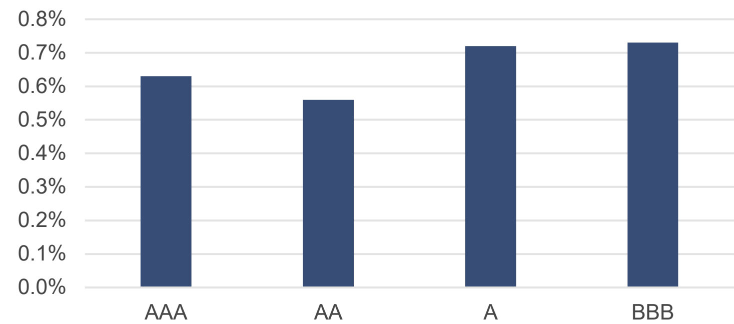
As investors weighed uncertain fiscal policy and a complicated economic outlook, the municipal yield curve steepened meaningfully. Refinitiv's AAA 1s10s curve slope increased by 45 basis points (bps), as 1-year yields declined 25 bps while 10-year yields rose 20 bps for the quarter, reflecting the market pricing more accommodative monetary policy in front-end yields and entrenched long inflation expectations in the back end. Lipper fund flows echoed the uneven pattern of the quarter, with municipal bond fund inflows reported eight out of the first ten weeks of the quarter turning to net outflows in the final weeks. Accelerating bid wanted activity steadily increased throughout the quarter, averaging $1.2B in daily par value. Not helping to steady market yields, primary market activity remained robust throughout the quarter, with $118B in new issuance representing a 19% increase over the same period last year.

In keeping with the prior quarter, index returns narrowly favored lower quality credits as credit spreads remained mostly stable in the uncertain environment. Total return reflected a tight clustering across the quality spectrum, with BBB-rated securities' total return of 0.75%, modestly outpacing returns of 0.73%, 0.57%, and 0.64% for A, AA, and AAA-rated bonds, respectively. Corporate-backed industrial development bonds, prepaid gas and electric structures, and transportation credits outperformed the broader index, while general obligation, water and sewer, and special tax revenue bonds underperformed. Higher profile names such as New York Metropolitan Transportation Authority (MTA) tightened by a few bps, in line with similar moves across the prepaid gas and electric sector. Notably, Los Angeles Department of Water and Power (LADWAP) bucked the stable trend and widened by over 70 bps to historically wide levels as large wildfires spurred significant selling early in the quarter.

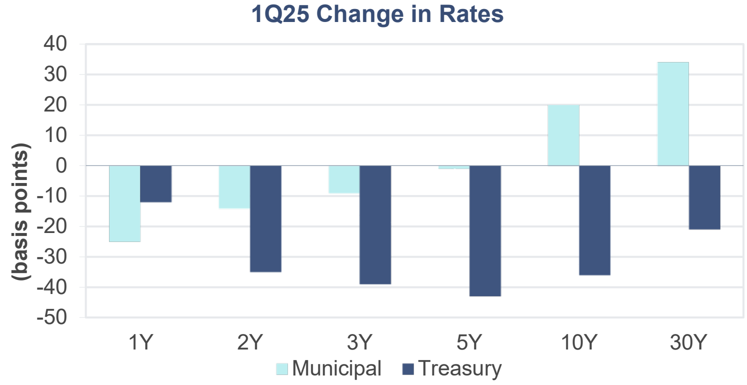
Refinitiv AAA Municipal Yields



1Q25 Total Return % by Rating Category



1Q25 Change in Rates



Data is as of 03.31.2025. Sources: Bloomberg L.P.; U.S. Treasury; Refinitiv. Yields are subject to market conditions and are therefore expected to fluctuate. Charts are for illustrative purposes only. The views expressed represent opinions of Sterling Capital Management. Any type of investing involves risk and there are no guarantees that these methods will be successful. Past performance does not guarantee future results.

STERLING CAPITAL

PULSUS UT LIBERA

Municipal Fixed Income Commentary

1st Quarter 2025

Credit fundamentals remained broadly sound to start the year, though sector-specific strains emerged during the quarter. Moody's reported that upgrades outpaced downgrades in full-year 2024 by a margin of more than 2-to-1, underscoring the overall stability of municipal credit. However, not-for-profit healthcare and higher education bucked the trend, with each sector experiencing more downgrades than upgrades over the same period. Furthermore, credit pressures related to federal funding policy in higher education and the Department of Government Efficiency (DOGE) driven terminations led Moody's to make negative outlook revisions on both the higher education sector, the only sector not on stable, and various District of Columbia related credits due to an outsized federal employment concentration. Despite these pockets of concern, state-level fiscal health remained historically strong. According to the National Association of State Budget Officers, states ended fiscal 2024 with a record-high median fund balance of 14.4% of spending, and projections point to continued growth in fiscal 2025. Consumer activity remained stable yet at a more measured pace during the quarter, as Transportation Security Administration (TSA) data showed average daily passenger throughput of 2.3MM, with total passengers for the quarter growing approximately 1.6% year-over-year, the lowest quarterly growth since 2021.

Our View

Given the array of potential policy and macroeconomic outcomes, we maintain a disciplined stance, looking for more compensation for risk taking in an uncertain environment. We look for moderating real economic growth in 2025 of 1.5% with risks to the labor market increasing, which we believe is likely to result in the Federal Reserve lowering rates in the second half of this year. Within municipal portfolios, we remain neutral on duration while maintaining a bulleted curve posture relative to indices in line with our expectations for modest yield curve steepening. We continue to be opportunistic in the current risk environment; during the quarter, we moved to an overweight position from an underweight in LADWAP revenue bonds, taking advantage of the significant spread widening, transacting at historically wide levels before credit spreads tightened 20 bps as the quarter ended. We acknowledge the near-term credit risks related to rebuilding from the devastating wildfires, but believe federal, state, and local support coupled with strong credit fundamentals pre-fire support for the long-term credit strength of the utility. We also continue to favor A-rated credits, particularly in the prepaid gas sector, which offers compelling relative value and satisfactory fundamentals.

While volatility and shifting narratives have kept risk sentiment on edge, in our view, we believe municipal credit remains well positioned to benefit from a risk-off backdrop due to its perceived safe haven status within fixed income markets. While uncertainty on real impacts from fiscal policy on higher education and the District of Columbia remain elevated, we favor larger universities better positioned to adjust to potential federal funding contraction. The District of Columbia, despite its approximately 25% dependence on federal employment, maintains a sound reserve position and low debt burden providing a solid backdrop to navigate a volatile employment impact. We view any sustained rise in yields as likely serving as a catalyst for renewed demand, particularly from long-term investors seeking tax-exempt income at more attractive entry points.

Disclosures

Past performance is not indicative of future results. Any type of investing involves risk and there are no guarantees that these methods will be successful. Economic charts are provided for illustrative purposes only. The information provided herein is subject to market conditions and is therefore expected to fluctuate.

The opinions contained in this presentation reflect those of Sterling Capital Management LLC (SCM), are for general information only, and are educational in nature. The opinions expressed are as of the date of publication and are subject to change without notice. These opinions are not meant to be predictions and do not constitute an offer of individual or personalized investment advice. They are not intended as an offer or solicitation with respect to the purchase or sale of any security. This information and these opinions are subject to change without notice. All opinions and information herein have been obtained or derived from sources believed to be reliable. SCM does not assume liability for any loss which may result from the reliance by any person upon such information or opinions.

Investment advisory services are available through SCM, an investment adviser registered with the U.S. Securities & Exchange Commission and an indirect, wholly-owned subsidiary of Guardian Capital Group Limited. SCM manages customized investment portfolios, provides asset allocation analysis, and offers other investment-related services to affluent individuals and businesses.

SCM does not provide tax or legal advice. You should consult with your individual tax or legal professional before taking any action that may have tax or legal implications.

The volatility of an index varies greatly. All indices are unmanaged and investments cannot be made directly in an index.

The ICE BofA 1-10 Year Municipal Securities Index is a subset of the ICE BofA U.S. Municipal Securities Index including all securities with a remaining term to final maturity less than 10 years.

Refinitiv Municipal Market Monitor (MMD) AAA benchmark: The Municipal Market Monitor has been delivering the municipal market's MMD AAA benchmark for over 30 years, and is integrated into the most comprehensive source of critical municipal market information.

Bid Wanted: An announcement by an investor who holds a security, commodity, or currency. It indicates that they are looking to sell the product, and are ready to entertain price bids for it. Interested parties may thus respond with bids.

General Obligation Bonds (GOs) are municipal bonds which provide a way for state and local governments to raise money for projects that may not generate a revenue stream directly.

Industrial Development Revenue Bonds (qualified small issue bonds or IDRBs) are securities issued by a local government agency for the purpose of acquiring or constructing capital facilities for use by private business and industry.

National Association of State Budget Officers Spring (NASBO) has been in existence for nearly 80 years and is a professional membership organization for budget and finance officers. The survey referenced is a semi-annual report gathered from all 50 state budget offices. Spring survey referenced: https://www.nasbo.org/reports-data/fiscal-survey-of-states

STERLING
CAPITAL
PULSUS UT LIBERA