A.H. Williams

Spinnaker Report

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AHW &Co Quarterly Commentary April 2019

Many of our clients have become accustomed to our active management and trading models. Historically we have concentrated our newsletters on current events and reflections on what has occurred, anticipation of what may affect performance in the future, and how we are positioning our portfolios.

Recently we were invited to speak at a forum that was designed as informational and educational without marketing or promoting products. In the exercise of taking a step back and looking at the municipal bond market from a different perspective we discovered many important facts that many investors take for granted or haven't been exposed to that we have included within this newsletter.

Many realize that the municipal bond market is large with approximately $3.8 trillion in bonds outstanding. What most don't realize is how complex the marketplace is, and even in this electronic age of information how little transparency exists. In the United States there are roughly 4,500 listed equities that are traded on various exchanges. In comparison there are approximately 117,000 different issuers of municipal bonds. Coupled with the fact that these issuers have 10-20 individual securities each, this amounts to over 1 million different municipal bonds that could be traded. This is why many advisors steer clients into ETFs and mutual funds, as they simply don't have the ability to achieve the type of security selection or execution that an active specialist can. In this report we have included many of the charts that graphically demonstrate the unique characteristics of the municipal securities marketplace.

AH Williams client portfolios were positioned for what was anticipated to be a typical January reinvestment period that favored more aggressive market exposure. January has been a reliable (80%+) time to harvest gains produced by demand that exceeds supply. Last year was one of the exceptions and we spent most of the year clawing back the disappointing results. With that in mind we were quick to take profits this year as a precaution. Most bond market observers had been predicting continuing rising interest rates as well as the Federal Reserve indicating 4 interest rate increases in 2019. Surprise! The combination of higher borrowing costs, lessening effects of the tax cuts, Eurozone economic weakness, trade tensions with China, Brexit, and finally a significant correction in US equity markets has generated a bond rally that months ago wasn't envisioned at all.

We took the opportunity when the market was weaker to rebalance client portfolios to maximize income. Borrowing costs are still relatively high and in response we have continued to seek out new issue bonds that represent what we consider excellent value and short-term trading opportunities that require little to no margin interest costs to clients. This strategy has paid off and we are pleased to have closed the first quarter with solid performance.

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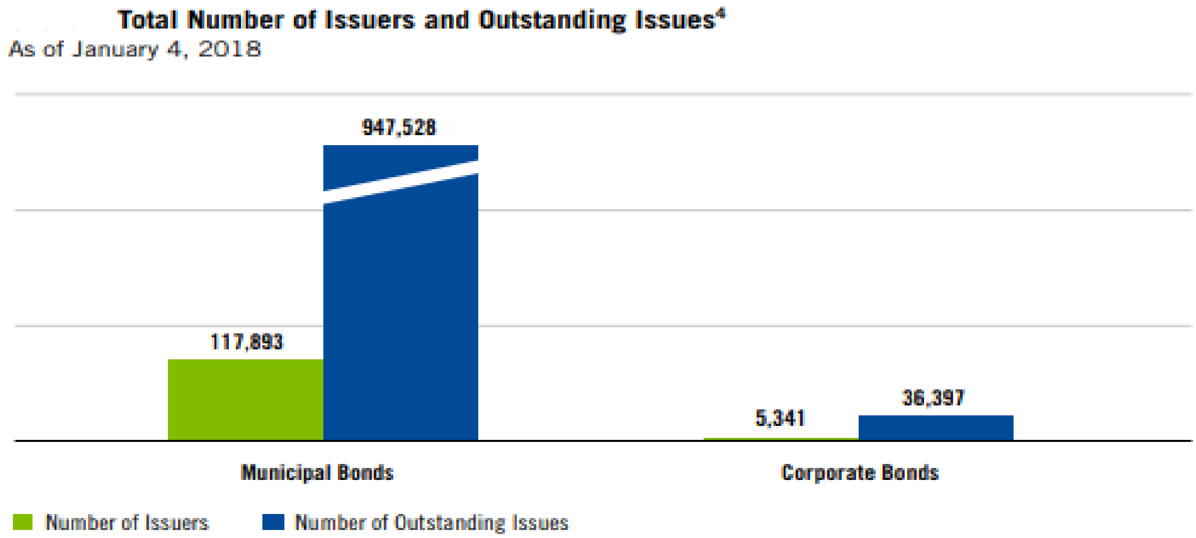
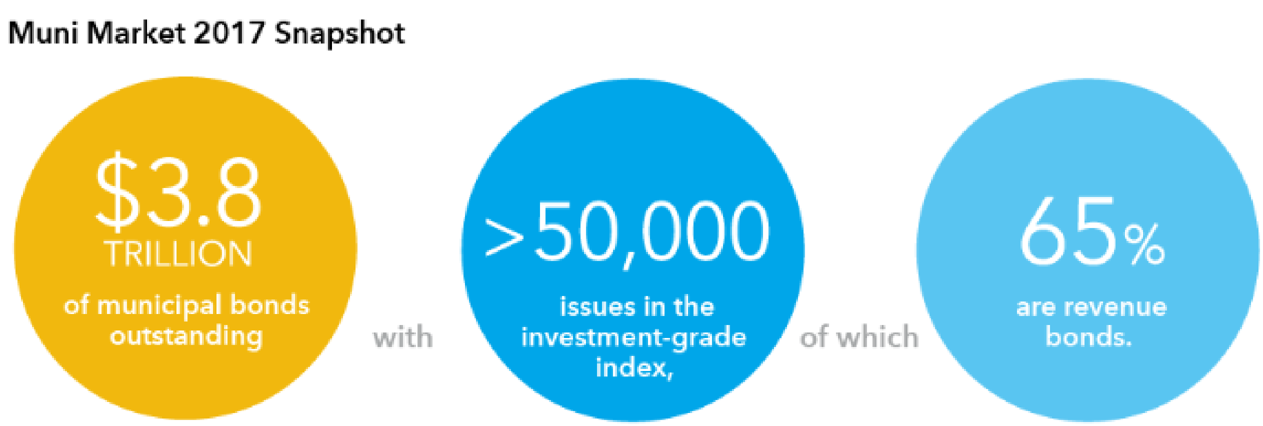
We will continue to employ these strategies and remain cautiously optimistic about the interest rate markets, and react accordingly as we see value. As is always the case our focus is on positioning our client portfolios with positive risk/reward opportunities.

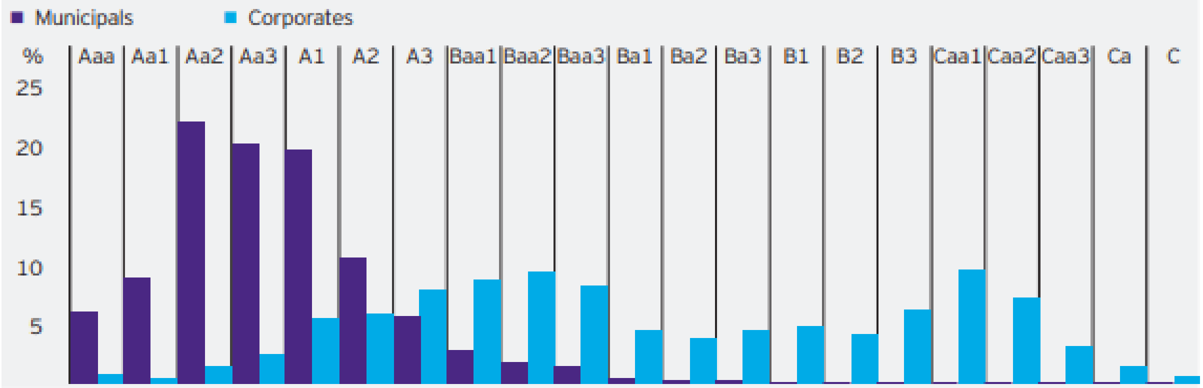


Source: Franklin Templeton



Sources: Securities Industry and Financial Markets Association (SIFMA), Bloomberg Index Services Ltd., as of 8/15/17.
Number of issuers and revenue bond proportion for Bloomberg Barclays Municipal Bond Index.

Figure 5: Reflecting their low propensity to default, nearly all municipal issuers have investment grade ratings



Source: Moody's Investors Service, US Municipal Bond Defaults and Recoveries as of Dec. 31, 2016 (latest available data)

Figure 6: Municipal default rates have historically been lower than those of corporate bonds
10-year average cumulative default rates

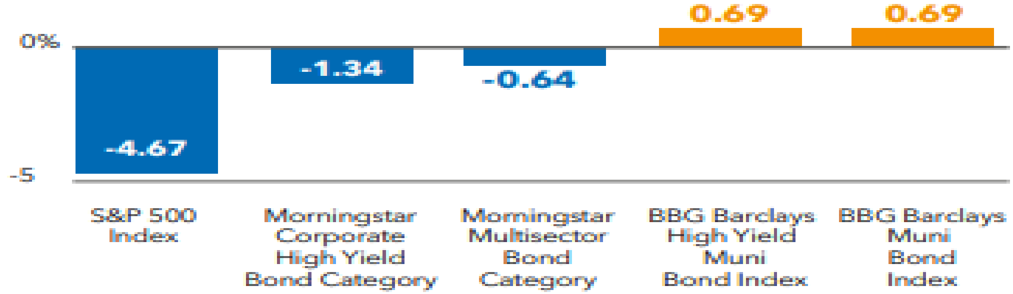
Rating categories	Municipal bonds (%)	Corporate bonds (%)
Aaa	0.00	0.38
Aa	0.02	0.78
A	0.07	2.22
Baa	0.40	3.93
Ba	4.23	16.28
B	17.77	36.17
Caa-C	26.41	50.31
All investment grade	0.09	2.38
All high yield	8.17	29.70
All rated securities	0.15	10.29

All rated municipal bonds have a lower 10-year cumulative default rate than Aaa-rated corporate bonds.

Source: Moody's Investor Services ("Moody's"), as of December 2016 (latest available data). Past default rates are no assurance of future default rates. Data shown for the time period 1970 through 2016 is the most recent data available. 2016 data may increase cumulative default rates for both municipal and corporate bonds. A credit rating is an assessment provided by a nationally recognized statistical rating organization of the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments or other debts. Ratings are measured on a scale that generally ranges from Aaa (highest) to C (lowest); ratings are subject to change without notice. For more information on rating methodologies, please visit moodys.com and select `Rating Methodologies' under "Research & Ratings" on the homepage.

Muni bonds are an important portfolio diversifier

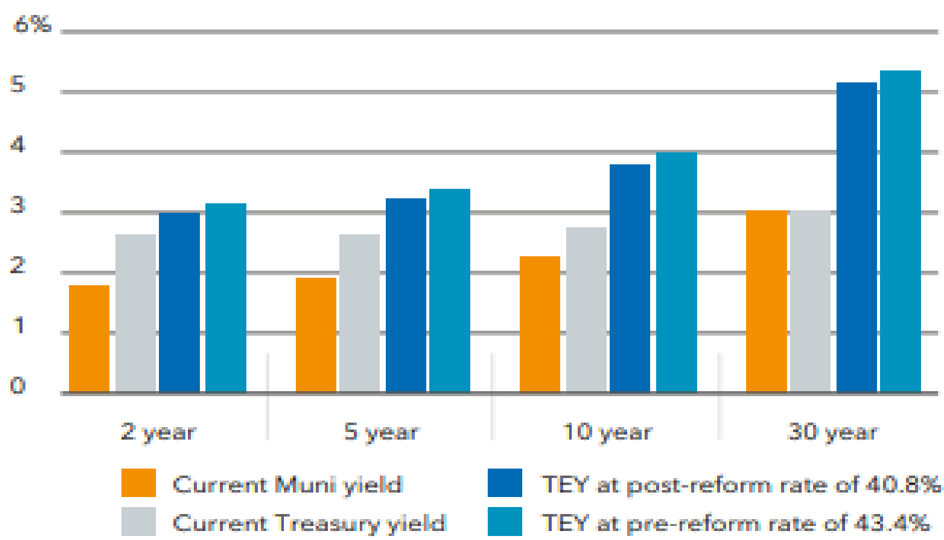
Average returns during S&P 500 selloffs



Source: Morningstar. S&P 500 selloff is defined as a calendar month period in which the S&P 500 Index fell by 2 or more percent. Returns are the average of 13 monthly periods from 12/31/10- 12/31/18. Diversification cannot assure profit or protect against a loss. Past performance is no guarantee of future results. Index performance is shown for illustrative purposes only. It is not possible to invest directly in an unmanaged index.

Munis offer yield benefit, even at lower tax rates

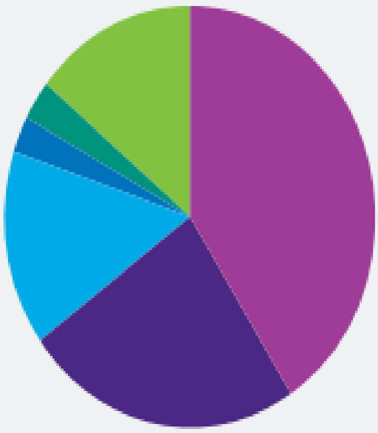
Yields before and after tax



Source: BlackRock and Bloomberg, as of January 7, 2019. Current Muni Yield is before tax. Tax equivalent yield (TEY) figures show the yield offered by the municipal bond after factoring in the high tax rate prior to reform at 43.4% and the current high tax rate of 40.8%.

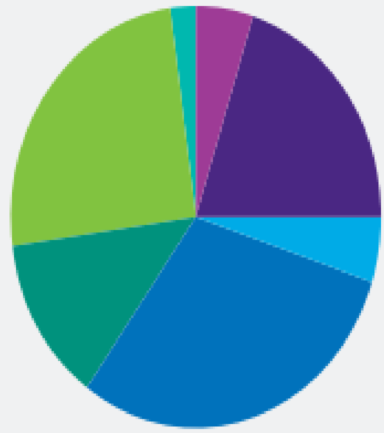
Figure 4: The $3.8 trillion municipal market is dominated by retail investors

Ownership of municipal securities and loans



	Billions	% of Total
Household	1561.6	41
Mutual funds and ETFs	934.7	24
Banks and credit unions	566.9	15
Rest of the world	103.9	3
Other	105.9	3
Insurance companies	530.2	14
Total	3803.2	100

Ownership of corporate and foreign bonds



	Billions	% of Total
Household	579.7	5
Mutual funds and ETFs	2484.4	20
Banks and credit unions	672.2	5
Rest of the world	3814.7	30
Other	1672.8	13
Insurance companies	3197.5	25
Local, state & federal governments	187.9	2
Total	12609.2	100

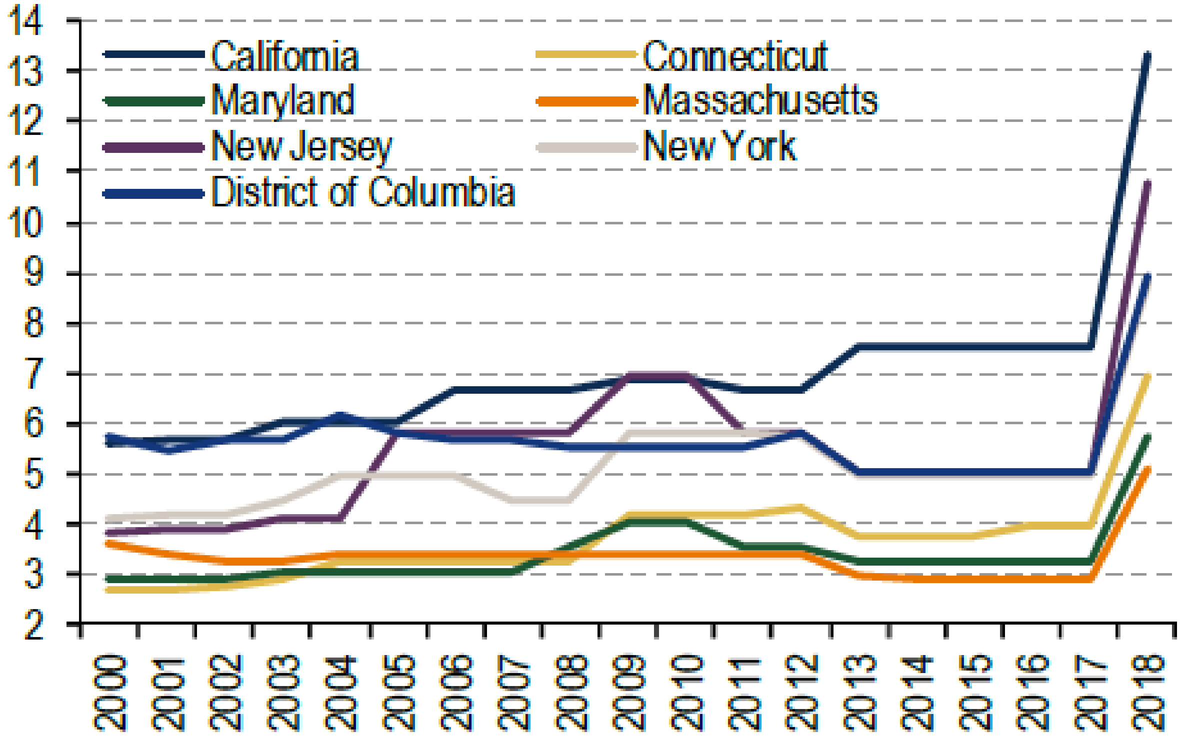
Source: Federal Reserve, as of Sept. 31, 2017 (latest available data)

Unlike the corporate and foreign bond markets, the municipal market is largely dominated by retail investors because of its federally tax-exempt status. Through both direct investment in individual municipal securities and indirect investment via mutual funds and ETFs, individual investors represent a combined 70% of total municipal bond ownership.

1 Source: Federal Reserve, as of Sept. 31, 2017 (latest available data)

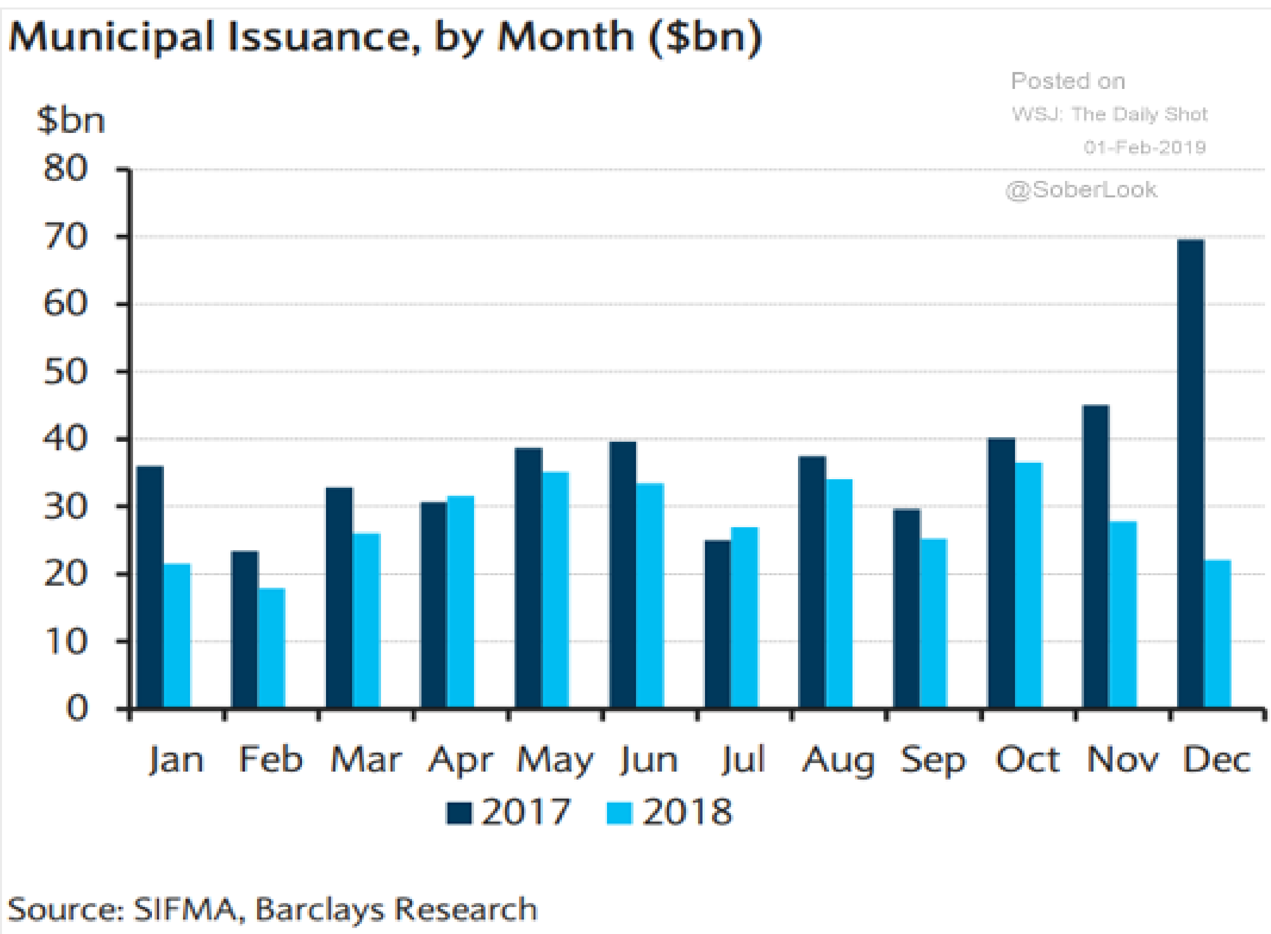
Changes in the State and Local tax (SALT) deductibility has made municipals in higher tax states more desirable and in considerable demand.

Chart 13: Effective top tax rate for select high-tax states, by year (%)

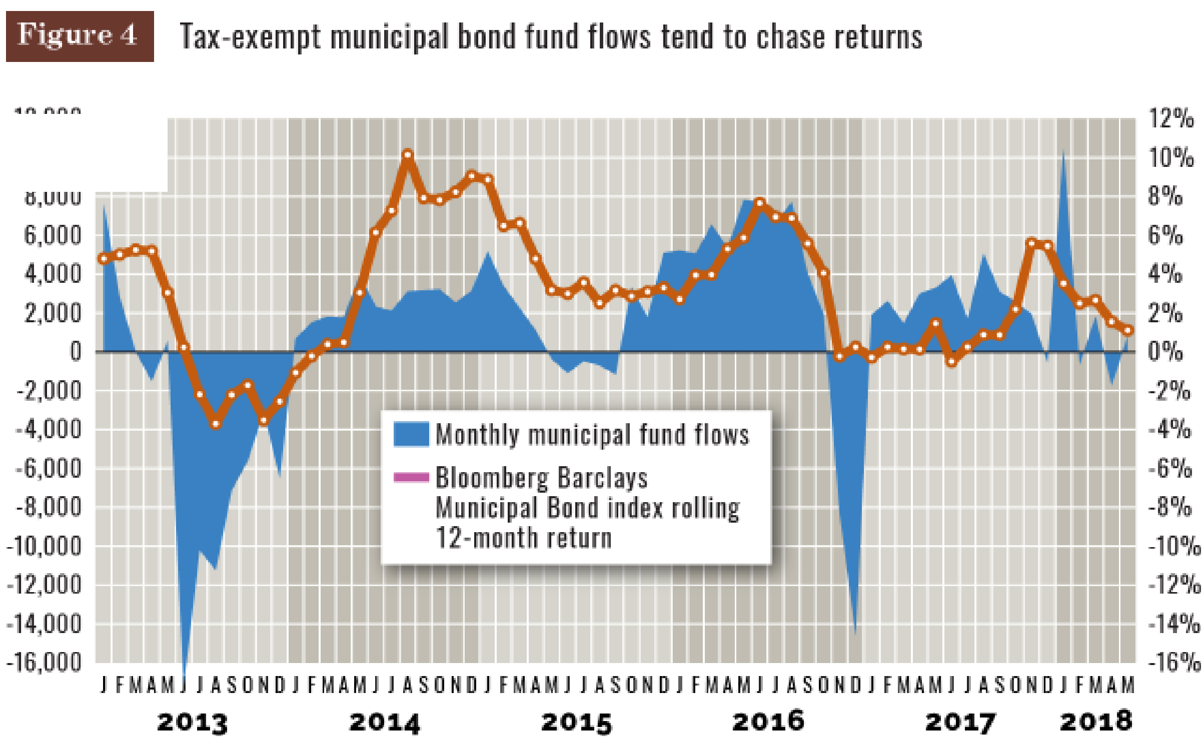


Source: BofA Merrill Lynch Global Research

Supply and demand are important considerations when timing bond purchases. Value is usually best when supply is the greatest.



Investors tend to buy at peaks and sell in valleys



Source: Pensions and Investments

- Rally Drives Muni Bonds Toward Best Quarterly Gain in Five Years
2019-03-28 17:30:00.0 GMT

By Claire Ballentine and Danielle Moran
(Bloomberg) -- The raging bond-market rally is propelling state and local-government debt to the best quarterly return in five years, amid surging demand for tax-exempt income and concerns about a slowdown in global growth.
Municipal bonds have returned 1.56 percent since the beginning of March, marking the biggest monthly gain since May 2017, according to the Bloomberg Barclays benchmark index. That brings the first quarter return to 2.87 percent, the most since early 2014, the data shows.
The gains in the $3.8 trillion municipal securities market accelerated after the Federal Reserve last week signaled that it's done raising interest rates this year. That has pushed 10-year state and local debt yields to the lowest since September 2017.
Munis have been aided by the new state and local tax-deduction limit that has boosted interest in the tax-exempt income that the securities provide. Investors added $1.63 billion to municipal-bond mutual funds during the week ended March 20, the eleventh straight week of inflows, according to the Investment Company Institute.

- Muni Market May See `Bullish Acceleration' on Dovish Fed: BofA
2019-03-25 13:34:23.704 GMT

By Amanda Albright
(Bloomberg) -- The municipal-bond market is likely headed for a "bullish acceleration" in the next few weeks after the Federal Reserve signaled it won’t raise rates in 2019, Bank of America Corp. strategists led by Philip Fischer said in a note.
* The strategists said they’re not seeing signs of a "rally exhaustion"
* The strategists forecast that 10-year AAA yields will reach 1.8% or lower in 2019
** "With a clear economic slowdown and surprisingly dovish central bank postures around the world, we think that the 10-year AAA is moving toward 1.80% or possibly lower this year. A much lower target is possible, but we think the Fed’s patience is likely to prolong the process, pushing muni yield declines into 2020": BofA
* "Investors should see ever stronger credits, lower ratios to Treasuries and lower absolute muni rates": BofA

- ‘Too Much Cash’ Chasing Bonds Holds Muni Prices Near Record High
  2019-03-22 17:30:00.0 GMT

  By Claire Ballentine
  (Bloomberg) -- America’s states and cities are poised to step up the pace of their bond sales over the next month, but there still may not be enough to go around.
  The $13.6 billion of municipal securities scheduled to be sold during the next 30 days -- marking the busiest slate since January -- is still less than the $17.5 billion that governments will pay off, according to data compiled by Bloomberg. At the same time, investors have been adding an average of $2 billion a week to tax-exempt mutual funds since the start of January, creating a scramble for securities that has left 10-year bond prices holding near their highest against Treasuries in at least two decades.
  “There’s certainly very strong retail demand, but you don’t have enough supply to meet that demand," said Jeffrey Lipton, head of municipal research at Oppenheimer & Co. "You have too much cash chasing too little product."
  The run-up has been fueled in part by the new state and local tax-deduction limit that has heightened interest in municipal bonds as a tax haven. Some of the states that were most affected by the deduction cap, including California, New York and New Jersey, are also among those where -- at least for now -- debt is set to be paid off at a faster pace than it’s sold over the next month. That dynamic could change, however, because many sales are scheduled with less than 30-days notice.
  The rally was given an added boost this week by the Federal Reserve, which said it no longer expects to raise interest rates this year. That caused yields on 10-year bonds to drop by about 0.11 percentage points this week to 1.95 percent, the lowest since December 2017. That yield is only about 80 percent of those on Treasuries, just slightly up from the 78 percent hit earlier this month, which was the lowest since at least 2001.

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