U.S. Municipal Bond Market

Another Prime Chance to Swing At—and Connect With—U.S. Municipal Bonds

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- Investors should take note again and pounce on appealing investment opportunities in the sector. Municipal bond market credit and technical indicators are again flashing the appropriate constructive signals.
- Municipal to Treasury Ratios are attractive, and over 100%. Municipal yields have risen to levels that deserve to be considered by not only conservative investors but also by those who are considering going a little further out on the investment-grade credit spectrum.
- We still believe that the investment-grade municipal sector is an opportune option for investors to wait-out the economic uncertainty likely ahead.
- The credit landscape encompassing the Golden Age of Public could become even more compelling that we initially expected. Credit quality remains very strong, and could improve.
- Public finance upgrades will outpace downgrades in 2022 and upgrades could outpace downgrades in 2023 but we need to see what happens on the economic front before we too enthusiastically endorse what is likely to happen next year.
- We want investors to continue to consider trading out of credits with substantial pension liabilities. It should be easier now to do this because of market circumstances.

Another Favorable Municipal Opportunity for Investors

Municipal bonds were an Exceedingly Appealing Fixed Income Opportunity back in May 2022. We doubled down on this approach a month later, in June, when we wrote Municipals Still Investable in Front of the Fed's June 2022 Announcement.

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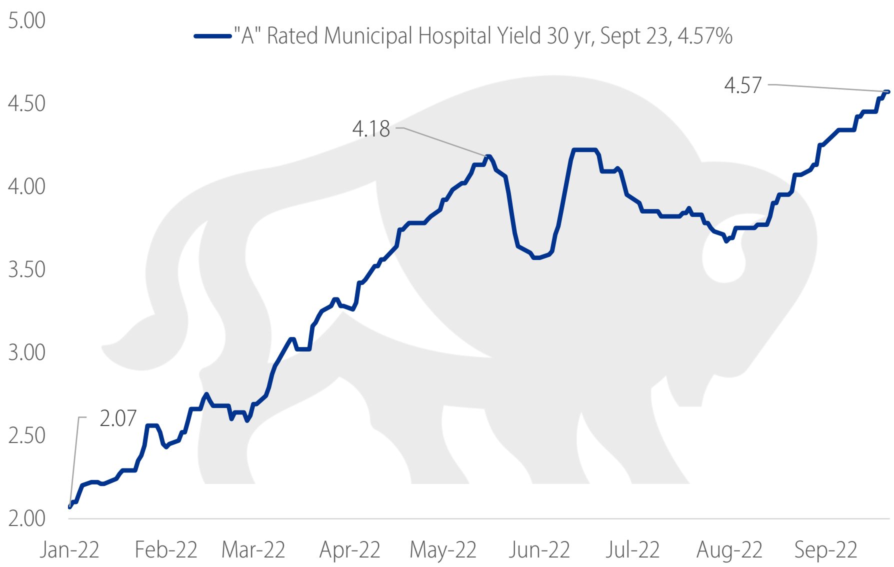
"A" Rated Hospital Yields Resumed Their March Higher in September



Source: Refinitiv and HilltopSecurities.

Please see disclosure starting on page 4.

Then in July we reminded investors that municipals would be an effective investment option to wait out the uncertainty, especially if an economic downturn materializes. We advised investors to add to or accumulate positions over time.

Municipal bond market credit and technical indicators are again flashing the appropriate constructive signals.

Investors should take note again. Municipal bond market credit and technical indicators are again flashing the appropriate constructive signals. This is once more an appealing time to begin to accumulate or to add to municipal positions. For some this may seem like a trade that goes against the grain. Another $2 billion flowed out of municipal bond mutual finds last week per Lipper data. In fact, investment dollars have flowed out of municipal funds in eight out of the last ten weeks for net outflows of about $9.3 billion. Frankly, the outflows could continue. We do not see any factors that could meaningfully turn this around in the near term.

But, technical and credit related indicators are back in investors' favor much like they were during the other favorable buying opportunities we pointed out this year. Municipal to Treasury ratios (M/T Ratios) are back over 100%, just over 103% to end last week. And municipal yields across the credit spectrum appear attractive. The 30-year AAA Municipal Market Data (MMD) yield finished last week at a 3.73%. Since the end of the first quarter of this year we have been constructive on "A" rated hospitals as a place where investors can stay in the investment-grade area while also getting an extra bump in tax-exempt yields. Investors who are interested in going a little further out on the credit spectrum will be able to attain yields close to or over 5.00% with "A" rated hospitals. The Refinitiv "A" rated hospital yield is at a 4.57%.

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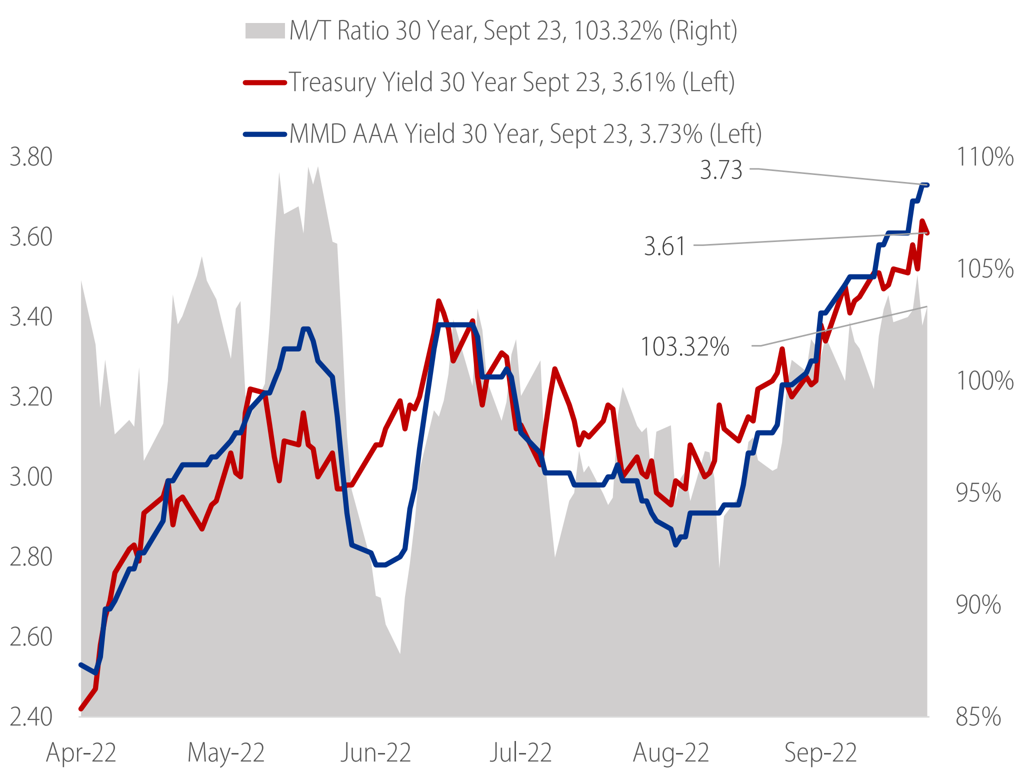
Relative Value & Technical Municipal Indicators are Attractive Again



Source: Refinitiv and HilltopSecurities.

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A More Compelling Golden Age of Public Finance - Credit Outlook

U.S. municipal bond sector credit remains strong. It could get stronger. Some have argued that credit quality in the U.S. municipal bond sector has peaked. That is an easy assumption to make. We think saying that U.S. municipal credit quality has peaked here is similar to saying the strength of the U.S. economy peaked in the 1960s.

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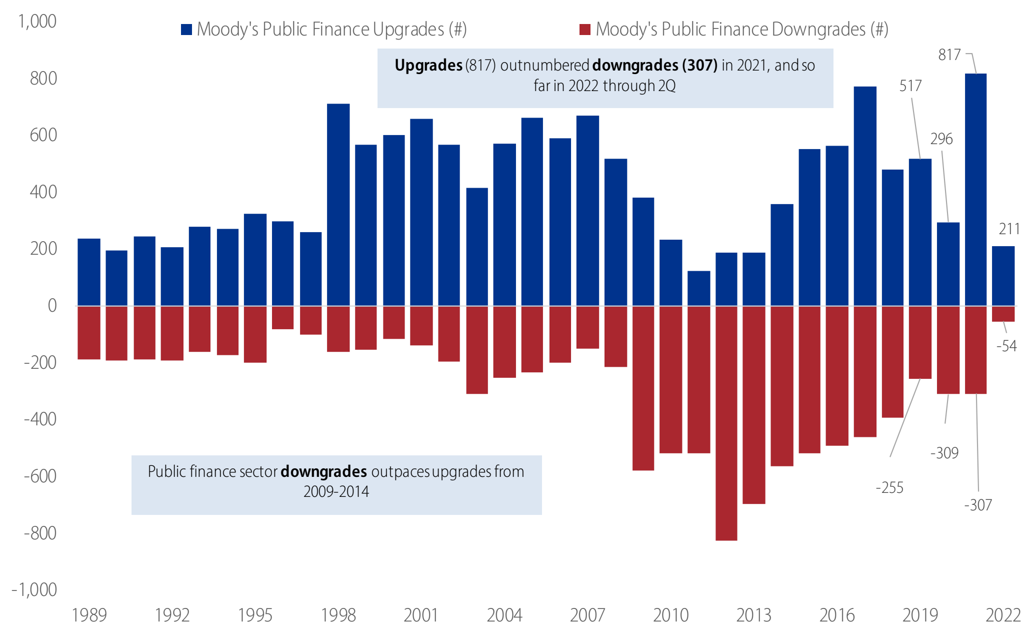
It is also very possible that U.S. municipal credit quality has not peaked. The Golden Age of Public Finance could become even more compelling, believe it or not. Our argument is that the plentiful U.S. fiscal policy transferred to state and local governments and other public finance entities in the 2021 Recovery Act is still being allocated and spent. State and local government revenues are still mostly neutral to slightly positive at the moment. Some are declining. We are seeing that California is flashing warning signs. Revenues in the form of income tax collections are more closely aligned with volatility in security values, they rise and fall much more regularly. Other revenue sources are slower to rise, materialize and then potentially fall. This oftentimes occurs on a multi-year time horizon. It doesn't just take months. These positive financial positions will cushion municipal credit through the Fed's soft landing, or a more-fierce economic downturn.

Public Finance Upgrades Have Outpaced Downgrades in 2021 and 2022 YTD



Source: Moody's and HilltopSecurities.

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U.S. public finance rating upgrades outpaced downgrades in the midst and in the wake of the COVID-19 epidemic and government-led shutdowns. Through the first two quarters of 2022 we have seen 211 upgrades and 54 downgrades of public finance credits by Moody's Investor Service. This trend is very likely to continue for the rest of 2022. It is very possible that upgrades outpace downgrades in 2023 as well. The timing and severity of a potential economic downturn could weigh heavily on this trend more in 2023. But, we still believe that the investment-grade municipal sector is an opportune option for investors to wait out the economic uncertainty likely ahead.

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Recent HilltopSecurities Municipal Commentary

- The Financial Data Transparency Act, A Potential Burden & Technological Upgrade for Public Finance if it Becomes Law, Sept. 14, 2022
- The Next Big Risk, Sept. 8 2022
- What the Inflation Reduction Act of 2022 Means for U.S. Public Finance, August 12, 2022
- The Municipal Sector is Where Investors Can Wait Out the Uncertainty, Next Recession, July 29, 2022

Readers may view all of the HilltopSecurities Municipal Commentary here.