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MacKay Municipal Managers Announces Top Five Municipal Market Insights For 2023.

PRINCETON, N.J. and LOS ANGELES, Jan. 12, 2023 /PRNewswire/ — MacKay Municipal Managers™, the municipal bond team of MacKay Shields LLC, today published its top five insights for the municipal bond market in 2023.

John Loffredo and Robert DiMella, co-Heads of MacKay Municipal Managers, said on the insights: "We are optimistic about the 2023 municipal market. We believe that preparation will help seize opportunities with higher accruals setting the pace. Disciplined portfolio management sets the stage for 2023 as higher tax free income streams, once again, provide a strong foundation from which relative value decisions can enhance performance".

MacKay Municipal Managers – Top Five Municipal Market Insights for 2023

Tax-Exempt Accrual Plays a Key Role in Total Return. Income has regained its prominence in municipal bond total return. Municipal investors can now realize much higher income accruals due to 2022's sharp rise in rates. Top income tax bracket investors, and especially those living in high income tax states, should find the higher tax-exempt income levels attractive on a taxable equivalent basis versus other asset classes. Raising accrual rates tends to reward investors who reinvest their dividends through the compounding effect of buying more shares at relatively lower average prices. We believe higher income levels can also better stabilize returns compared to the last several years, when low coupons and yields offered little cushion against price declines. Additionally, we believe investors who remained in passive strategies have missed this opportunity while hoping the market would recover. Raising accrual rates required actively replacing low book yield positions with much lower priced, higher yielding bonds, trades typically known as tax swaps. We believe investors can benefit from current market accrual rates in 2023 and beyond.

Overweight General Obligation and Essential Service Bonds. We believe essential investment grade sectors, such as General Obligation bonds and Water & Sewer bonds, will regain favor with investors in 2023. We expect greater demand for traditional municipal bonds such as bonds backed by the taxing power of general obligation issuers or secured by the revenues of essential service providers like public water and sewer authorities. We anticipate continued investor uncertainty over the path of inflation, the Federal Reserve's policy decisions, and the potential for a recession will be the reason why investors find comfort in the core municipal sectors. In addition, investors should favor shifting to higher quality sectors that now pay higher accrual rates. We believe core sectors of the municipal market outperform in 2023.

In a Bifurcated High Yield Municipal Market, Liquidity Drives Performance. We believe a disciplined pursuit of liquidity will be rewarded in the 2023 high yield municipal market. In 2022, the massive wave of high yield fund redemptions resulted in an equally sized selloff of bonds as funds sought liquidity. High yield municipal funds primarily sold their more widely held and better quality positions to meet those redemptions resulting in those more liquid bonds underperforming relative to holdings that did not trade throughout the year. In anticipation of a healthier market in

2023, we believe those underperforming bonds now provide the opportunity to outperform as investment discipline re-emerges. In our opinion, discipline in the high yield municipal market goes beyond credit research to include an understanding of liquidity, tradability, and the investor base. We expect inflows will return to the high yield municipal market and issuance will be light. As a result, we believe the more liquid part of the high yield municipal market outperforms in 2023.

Fund Flows Drive Recovery in Long Municipal Bond Prices. We believe exposure to longer-term bonds drives return in 2023. Municipal mutual funds and Exchange Traded Funds are the natural buyer of the long end of the municipal curve. We expect a return to positive mutual fund flows results in the outperformance of longer-term bonds. Additionally, mutual funds will likely seek to increase their distribution yields, causing them to extend the maturity and duration profile of purchases. As a result, bond structures with long durations and discount prices enhance return potential relative to shorter duration, premium structures. Finally, the municipal to Treasury yield ratio curve remains steep, indicating that the longer end of the municipal market offers better value opportunities. Long municipal bonds with ratios in the mid 90% range are cheap on a relative basis. We believe portfolios with exposure to longer maturities outperform.

Thinking Outside the Box – Using Short Taxable Municipals to Enhance After-Tax Performance. We believe shorter-term taxable municipal bonds provide better after-tax value than comparable maturity tax-exempt bonds. Investing in shorter term municipal bonds, a tactic used to add liquidity and/or manage duration in a portfolio, becomes more difficult when such bonds are overpriced. Shorter-term tax-exempt bonds have risen in price beyond fair value primarily due to passive investor demand. In 2023, we expect demand for shorter-term tax-exempt bonds to continue unabated and we do not expect that new issuance sufficiently offsets that demand. As a result, we believe shorter-term tax-free municipal to Treasury yield ratios remain rich through the year. Comparable maturity taxable municipal yields, however, offer better value on an after-tax basis. The taxable municipal market's continuing expansion, in both size and breadth, has brought a new dimension to relative value trading in the municipal market. We believe investors should favor shorter-term taxable municipal bonds because they provide competitive after-tax yields, attractive spreads to Treasuries and the same high credit quality of the tax-exempt municipal asset class.

About MacKay Shields LLC

MacKay Shields LLC (together with its subsidiaries, "MacKay")*, a New York Life Investments Company, is a global asset management firm with $126 billion in assets under management as of September 30, 2022. MacKay manages fixed income and equity strategies for high-net worth individuals and institutional clients through separately managed accounts and collective investment vehicles including private funds, UCITS, ETFs, closed end funds and mutual funds. MacKay maintains offices in New York City, Princeton, Los Angeles, London and Dublin. For more information, please visit www.mackayshields.com or follow us on Twitter or LinkedIn.