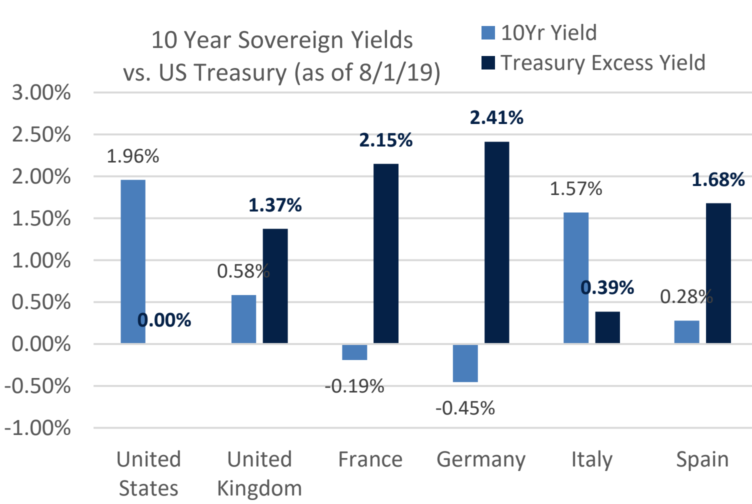
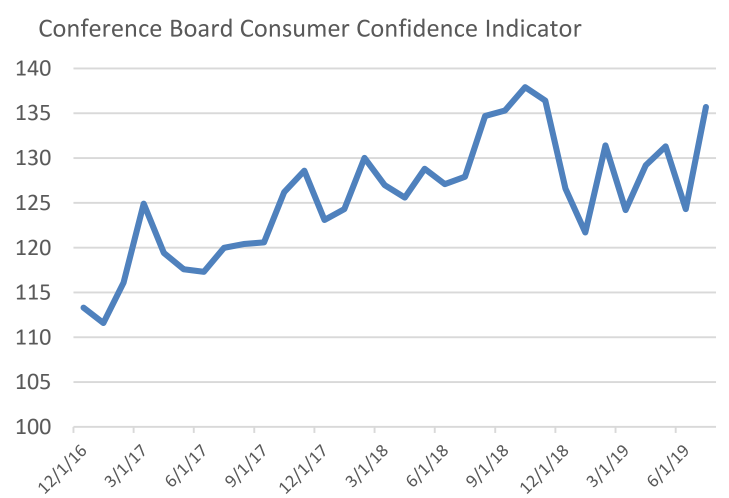
INSIGHTS & OBSERVATIONS

ECONOMIC, PUBLIC POLICY, AND FED DEVELOPMENTS

- Considering the lack of any real uncertainty that it would happen, the first Fed Funds rate cut in 11 years dominated July's news. While there was some speculation about the prospect of a 50 basis point cut (largely fueled by a speech by NY Fed President John Williams), Chairman Jerome Powell ultimately delivered a 25 basis point cut on the 31st. In his Q&A he described the move as an "insurance cut" and a "mid-cycle adjustment" rather than the first of a "long series of rate cuts." Both the equity markets, which had hoped for a series of rate reductions, and President Trump, who wanted a more dramatic cut, expressed disappointment. Equities quickly dropped more than 1% on the news, the first such decline in two months. ***While there is evidence that the US and world economies have slowed, they have yet to stall and modest growth should continue to support asset prices without significant fiscal easing, provided global trade conflict does not spiral out of control.***
- The Q2 GDP report was similarly unsurprising as growth slowed from Q1, but to a better-than-expected 2.1%. The drivers of growth were also broadly in line with expectations; net exports weighed on growth as did a decline in inventory levels, although evidence of retail strength in recent months, including a knockout May report released last month and surging consumer confidence indicators, led to a solid contribution from consumer demand. ***Indeed, the second quarter was an inverse of the first, with private sales to domestic consumers coming in well above GDP at 3.5%; in Q1, the strong headline number was belied by weak final sales.*** The impact of the trade war continues to make itself felt; in addition to weak net exports, business investment essentially stalled as firms try to make sense of a rapidly changing and highly volatile global trade environment.
- On that note, President Trump surprised the markets on August 1st by announcing a 10% tariff on all remaining Chinese imports effective September 1st. Equity markets sold off and yields dropped sharply on the news. ***While it remains possible that this is another "negotiation technique", the Chinese quickly announced a currency devaluation before taking a step towards stabilization, and the Trump Administration designated China a "currency manipulator". These developments aggravated already tense negotiations, dampened hopes for resolution, and are likely to further slow global growth.***
- Overseas, Mario Draghi left rates unchanged on July 25th, but citing an outlook getting "worse and worse" he set the stage for future cuts. Markets expect a 10 basis points cut to -50 basis points, likely in September. German bunds hit all-time lows on the news, with the 10Yr falling to a then-record -0.42%. Meanwhile, the Tories elected Boris Johnson as party leader, in turn making him the new UK Prime Minister. While initial market reaction was muted, the pound began sliding as traders grappled with Johnson's commitment to pursuing even a no-deal Brexit. ***Lower European sovereign yields and political instability from either a no-deal Brexit or the collapse of the Tory government over an inability to deliver Brexit (we see them as equally likely) should keep a ceiling on US Treasury yields in coming months.***
- At home, a tentative bipartisan debt ceiling deal cleared the House and Senate and now awaits Trump's signature. The deal would waive the debt ceiling through July 2021, permanently end sequestration, and caps discretionary spending at $1.37 trillion for 2020 and $1.375 trillion for 2021, an increase from FY19's $1.32 trillion. ***In the short run this deal removes a major political risk from recently turbulent markets; longer term, we expect larger deficits and greater Treasury issuance.***



Source: Bloomberg



Source: Bloomberg

FROM THE TRADING DESK

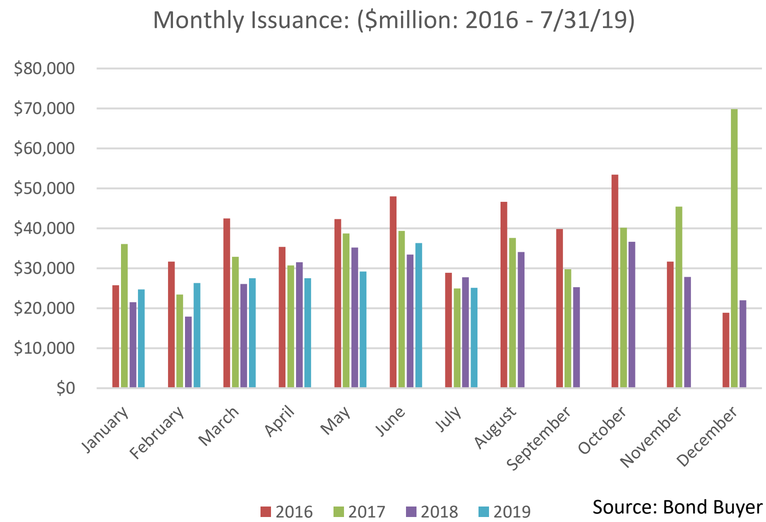
MUNICIPAL MARKETS

- On the municipal front, we see a continuation of intense buying pressure. August began with equity markets shaken by another flare up in the US – China trade dispute. ***In the face of uncertainty and volatility risk appetites can be compromised, and high-quality municipals are often seen as a safe-haven asset class that has historically demonstrated a low correlation to equities and other riskier assets.*** Furthermore, investors will be looking to reinvest a large volume of principal redemptions and income payments. As a proxy for investor demand in a retail-driven market, one need only look at mutual fund flows. Municipal funds have now posted 30 consecutive weeks of inflows and gathered year-to-date net assets of $52.9B, already the highest annual net inflow on record.
- Municipal issuance was consistent with historical trends and dipped during the month of July to $25.1B, although we expect an accelerated pace coming to market as the year moves on. Looking forward, 30-day visible supply has jumped to $16B, which is the highest it has been for the year and significantly above the YTD average of $7.8B. The average August issuance since 2015 is $37.6B, so we are likely to see a pick-up in new supply to end the summer, particularly given the likelihood of low municipal yields incentivizing issuers. Additional supply would be welcome as new municipal offerings have typically been oversubscribed, at times highly so.

Correlation of Bloomberg Barclays Municipal Index to Other Asset Classes (6/30/09-6/30/19)	
S&P 500 Index	-0.07
MSCI EAFE Index	0.05
MSCI Emerging Markets Index	0.11
Bloomberg Barclays Corp. High Yield Bond Index	0.23

Correlation between two asset classes is measured on a continuum of -1 (perfect negative relationship) to +1 (perfect positive correlation). Correlation coefficients were calculated based on quarterly total return data.

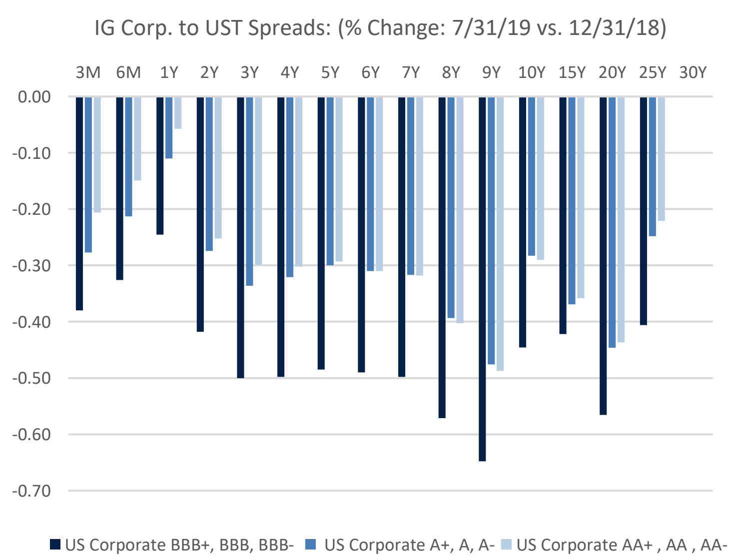
Source: JP Morgan Asset Management



Source: Bond Buyer

TAXABLE MARKETS

- The Investment Grade bond market continued to roar in July as investor appetite for income showed no signs of letting up, although a trade induced equity sell-off on August 5th at least temporarily tempered risk appetite even among higher quality issues. Nonetheless, ***July's markets were characterized by a dovish Fed, strong mutual fund inflows, and limited new issuance, which collectively has sustained a robust environment for higher grade taxable securities.*** The Bloomberg Barclays US Corporate Index OAS ended the month at 108 basis points above Treasuries, 22 basis points higher than the June sell-off high, and 50 tighter than where 2019 began.
- Against this backdrop, many investors have been inclined to move down in quality to meet yield expectations. As a result, lower quality IG (BBB) spreads have tightened dramatically and recently outperformed other ratings categories. ***Although corporate credit quality remains on solid footing, we feel investors are not being adequately compensated for taking on lower grade credit risk given the extent to which quality premiums have diminished. In our view, caution is in order.***



Source: Bloomberg

PUBLIC SECTOR WATCH

CREDIT COMMENTS

SALT Deduction and Outmigration

- ***Despite predictions to the contrary, there have yet to be measurable signs that the federal cap on state and local tax (SALT) deductions is resulting in outmigration of residents in high tax states.*** In the 5 states where the SALT deduction represents the largest share of total federal adjusted gross income (NY, NJ, CT, CA and MD) migration rates at the end of 2017 remained below pre-recession levels. Only CT and MD have out-migration rates above the 50-state median.
- ***Our interpretation is that job opportunities and demographic trends influence migration patterns far more than tax rates.*** States with growing economies that attract workers face less risk of population loss and subsequent credit challenges.
- We will continue to monitor the impact of 2017's tax reform, particularly relative to evidence of out-migration. Older, wealthier residents are a demographic to watch as some fear they may leave high tax states and take a disproportionate share of the tax base.

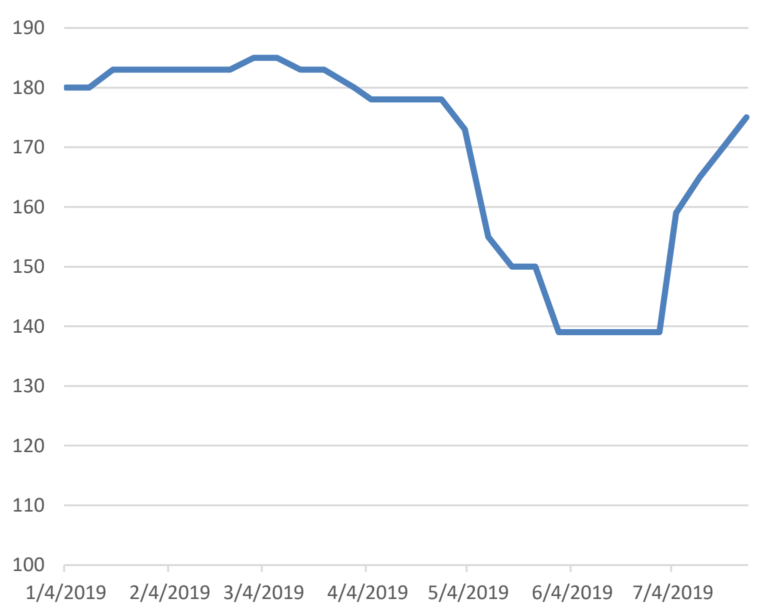
Highest Out-Migration Rates	SALT % of AGI	SALT Rank	Out-Migration Rank
Delaware	4.5 %	24	1
Alaska	1.5 %	50	2
North Dakota	1.6 %	47	3
Hawaii	4.5 %	23	4
Wyoming	1.6 %	49	5
Highest SALT As % of AGI			
New York	9.1 %	1	38
New Jersey	8.7 %	2	29
Connecticut	8.3 %	3	19
California	7.9 %	4	49
Maryland	7.7 %	5	16

Data as of 12/31/17
Source: Moody's, US Census Bureau

Illinois invalidation lawsuit

- A hedge fund and think tank are challenging two series of the State's GO bonds totaling $14.3B, claiming they were deficit financings that violated the state constitution linking debt issuance to a "specified purpose." The suit argues that issuing debt to finance structural deficits is not a "specific purpose". Bonds traded off in response, despite most market participants giving little weight to a successful challenge.
- ***This development highlights the risk of unquantifiable external shocks, which tend to be more prevalent in entities facing financial, economic and/or politically challenged environments.***

Illinois GO 10-year Credit Spreads
Year-to-Date (basis points)



Source: IDC, MMD

Alaska's significant cuts to universities results in downgrades and emergency declarations

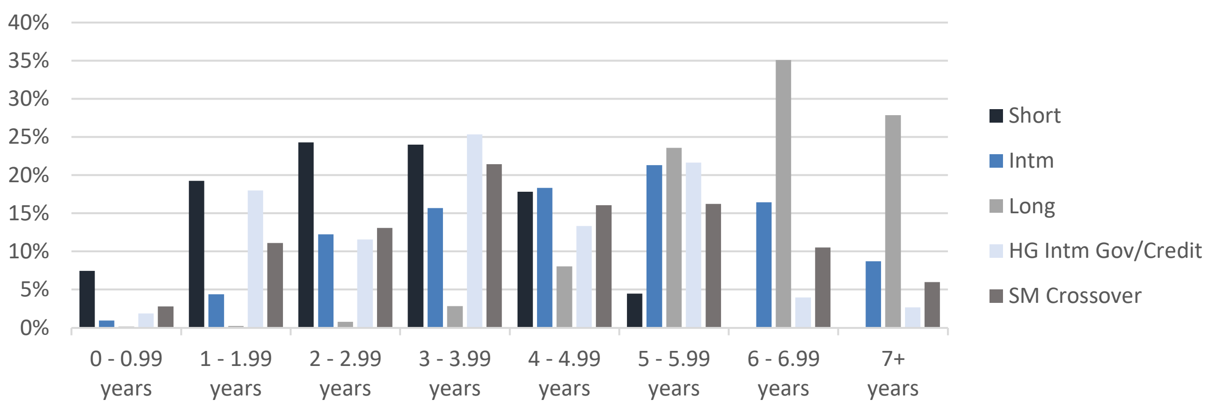
- Governor Mike Dunleavy vetoed $130M in state funding for the University of Alaska, a 41% cut, in an attempt to balance the state budget and avoid cutting dividend payments to residents from the State's Permanent Fund. Moody's immediately downgraded the University system by three notches to Baa1 and the University board declared "financial exigency".
- ***Although we do not own any University bonds in the Alaska system, this is as an example of why the risks of state budget challenges trickling down to lower entities must be considered in credit analysis.***

STRATEGY OVERVIEW

PORTFOLIO POSITIONING (As of 7/31/2019)

	Short-Term Municipal	Intermediate Municipal	Long Municipal	High Grade Intermediate Gov/Credit	Strategic Muni Crossover
Average Modified Duration	2.84 years	4.66 years	6.16 years	3.71 years	4.04 years
Average Maturity	3.23 years	6.52 years	12.29 years	4.22 years	5.16 years
Yield to Worst	1.11%	1.31%	1.68%	2.29%	1.76%
Current Yield	4.28%	4.11%	3.97%	3.73%	4.09%

Duration Exposure by Strategy (as 7/31/2019)



Source: Investortools Perform, Appleton Partners, Inc.

OUR PHILOSOPHY AND PROCESS

- Our objective is to preserve and grow your clients' capital in a tax efficient manner.
- Dynamic active management and an emphasis on liquidity affords us the flexibility to react to changes in the credit, interest rate and yield curve environments.
- Dissecting the yield curve to target maturity exposure can help us capture value and capitalize on market inefficiencies as rate cycles change.
- Customized separate accounts are structured to meet your clients' evolving tax, liquidity, risk tolerance and other unique needs.
- Intense credit research is applied within the liquid, high investment grade universe.
- Extensive fundamental, technical and economic analysis is utilized in making investment decisions.

APPLETON PARTNERS, INC.

ONE POST OFFICE SQ. BOSTON, MA 02109 TEL. 617.338.0700 WWW.APPLETONPARTNERS.COM