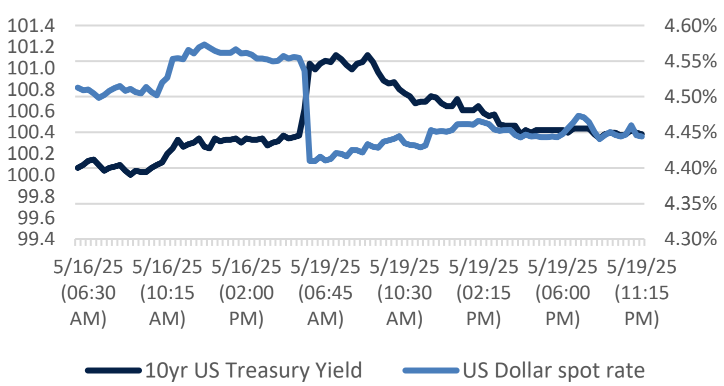
INSIGHTS & OBSERVATIONS

ECONOMIC, PUBLIC POLICY, AND FED DEVELOPMENTS

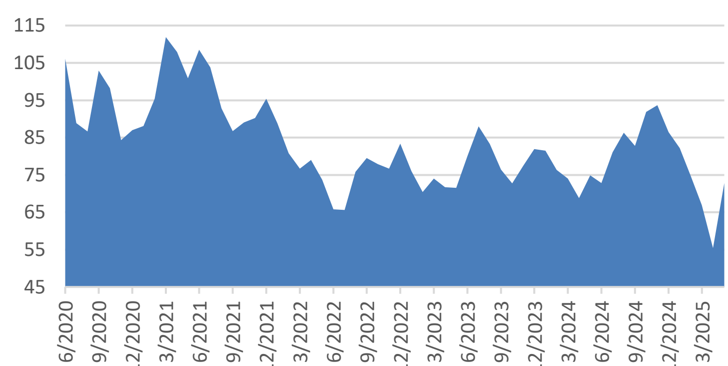
- There seems to be a "Groundhog Day" element to writing economic commentary lately. At the start of June, we are still concerned about tariff uncertainty, as well as the scope of federal layoffs, and unless you look at the details, it is entirely possible to miss the fact that another month has passed.
- **The US International Trade Court ruled on 5/28 that President Trump had no legal basis to assess tariffs using the International Emergency Economic Powers Act**, and they would need to be reversed. Tariffs remain in place while the administration appeals; however, we see this as less a comment on the likelihood of a successful appeal than on simple logistics. It is easier to collect tariff revenue that will eventually be returned than to try to tariff imports well after they have arrived.
- **President Trump has several other avenues available to apply tariffs, so we believe this decision prolongs rather than ends the trade war and will ultimately still be a negative for growth.** We expect President Trump to be more aggressive in the use of other tariff mechanisms in the meantime, and he doubled steel and aluminum tariffs to 50% shortly after this decision. This decision also weakens the US's negotiating position, and we see a reduced likelihood of any significant trade deals being reached until after the appeal. Interestingly, Treasury yields rose when news of the tariff decision broke and then fell when the courts announced they would be left in place during appeal. This suggests the market is more concerned with the ballooning US debt than the growth implications of restrictive tariff policy.
- The House passed the "Big Beautiful Bill Act" on 5/22, sending a Tax Cuts and Jobs Act extension and debt ceiling increase into reconciliation. There are significant differences between the House and Senate bill, including the size of tax cuts, so for now we believe specific provisions don't matter nearly as much as the size of the contribution to the national debt. If the broad contours of the bills hold, it is **likely to close the deficit by 0.1 – 0.2% from the current -6.8% of GDP**, **meaning the national debt will still increase, but slightly slower than before**. The Congressional Budget Office's estimate released on 6/4 puts the size of this increase at $2.4T over ten years. They also estimate $2.9T in tariff-related revenue outside the budget, so it's at least possible that tariffs – if they were to remain in place at April levels, which is uncertain – could offset most of the additional cost of the extension. If so, the annual deficit would likely be even smaller, though still negative, perhaps in the -5% range. This is still not a great trajectory and Treasury yields rose as its passage became more likely.
- **Moody's downgrade of the US Treasury to Aa1/Stable on 5/16 was well digested by the markets**; yields rose, and the dollar fell on the news, but the moves were not large and had partially reversed by Monday's trading. This market reaction was quite different than earlier S&P and Fitch downgrades when the dollar rose and yields fell in a flight to quality. A sovereign default is improbable for any entity that issues debt entirely in its own currency, and the downgrade reflects the possibility of the US eventually monetizing its own debt, rather than defaulting. The restrained nature of the market move suggests a very low probability of this occurring, and we remain very confident in the Treasury's creditworthiness.
- **The Conference Board's Consumer Sentiment indicator rebounded sharply in May**, from an abysmal 54.4 to a still soft 72.8. Survey responses suggested the temporary reduction in tariffs on Chinese imports as a primary driver. While on one hand these are "low information" respondents who do not carefully follow financial markets, on the other that makes them representative of most US consumers, and improvements in sentiment may support spending and keep growth from softening as much as we fear it could.

Yields Rose, Dollar Dropped on Moody's Treasury Downgrade



Source: Bloomberg, ICE

Consumer Expectations Rebound on Chinese Tariff Reductions



Source: Conference Board

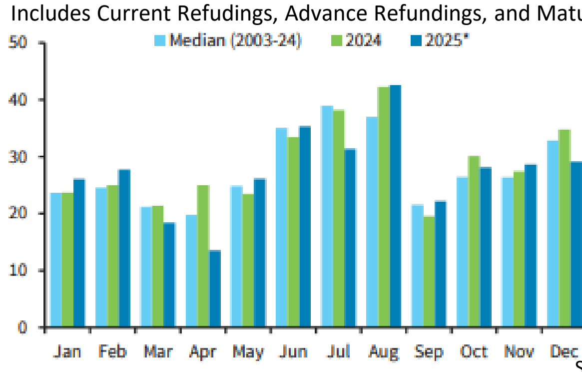
Sources: FHN Financial, Conference Board, Congressional Budget Office, Moody's

FROM THE TRADING DESK

MUNICIPAL MARKETS

- **The municipal curve bull steepened during May, with the front end lower in yield by 10-15 bps and the 5-year curve dropping 18 bps.** The 7-year portion of the curve saw yields fall 13 bps, while 10-years moved only marginally by 1 bp. Maturities over 10 years faced selling pressure that caused yields to rise by up to 14 bps for 30-year maturities. The 2s-30s curve slope steepened by 29 bps on the month, with 12 bps of steepening coming just from the 10 to 15-year part of the curve alone.
- Treasury yields remained volatile with upward pressure and municipals closed May richer on a relative basis. The most pronounced effects of this move impacted the front end through the belly of the curve, specifically 2 to 7-years for municipals, where ratios tightened by 4-7%. The effect was more muted with longer maturities. The 5, 10, and 30-year AAA Muni/UST ratios ended the month at 71%, 75%, and 91%, respectively. The 30-year ratio is in line with the 5-year average, and **although 5 and 10-year ratios remain tighter than their historic average, today's levels are up from prior lows, and we feel they offer an attractive entry point given absolute yields.**
- May was marked by a robust primary calendar of $50B, maintaining a recent trend of high issuance. Per Barclays Research, May issuance was 6% higher than the same period last year and notably larger than the $32B average of the prior five years. **May issuance brings the YTD total to $216B, an 11% increase over 2024.** Municipal supply was absorbed by $3.1B of subscriptions into municipal ETFs and mutual funds, partially offsetting a surge in April redemptions. The biggest beneficiaries have been ETFs (+$7.8B YTD), while open-ended municipal mutual funds remain a laggard (-$1B YTD).
- **The summer months typically see strong technicals for the muni market,** as trends for the past few years have seen heightened redemptions in summer bolstering favorable supply/demand dynamics. We expect that trend to continue with CreditSights estimating redemptions for May coming in 21% higher than last year, and June, July, and August estimates totaling $149M.

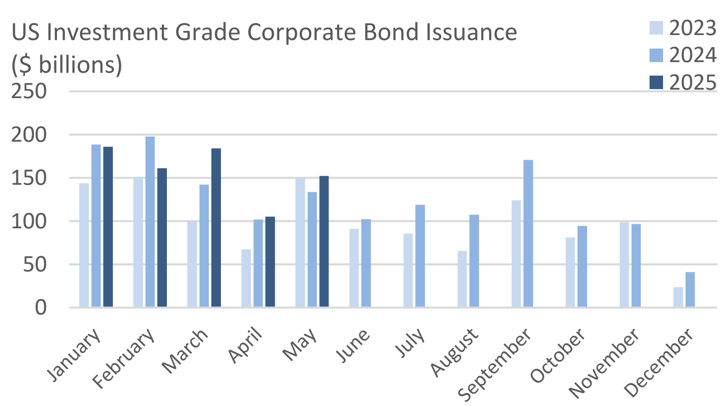
Municipal Redemptions ($, billions):
Includes Current Refudings, Advance Refundings, and Maturing Bonds



Source: Bloomberg

CORPORATE AND TREASURY MARKETS

- **Investment Grade Corporate credit spreads have rebounded well from early April global trade-induced turbulence**, tightening considerably later that month and in May. Option Adjusted Spreads (OAS) on the Bloomberg US Corporate Bond Index began May at +106 bps, down 13 bps from a YTD high of +119 bps before tightening further to 88 bps by month's end, a level not seen since late March. We expect credit spreads to remain in their current range for some time, although short-term volatility is anticipated as policy and economic news comes forth.
- Syndicate desks had an active month after a very slow April as issuers brought $152.5B of new debt to the markets. It was the busiest May since 2020 when $242B of new Investment Grade Corporate supply was issued. **YTD issuance now stands at $788.5B, 3% above the same period of last year.** The first week of June is off to a strong start and is on pace to meet expectations of $10B.
- **Appetite for credit remains robust with high demand for longer dated credits.** Market concessions have been limited and on par with the YTD average of only 3.5 bps. The health of risk appetite is anecdotally evidenced by certain deals enjoying negative concessions and several order books being 4x covered. Market technicals remain favorable, leaving issuers with ready access to the debt markets, and we expect corporations to take advantage over the second half of the year.
- US High Yield returns reached monthly levels not seen since July 2024 as worries eased in the aftermath of the 90-day tariff pause. The Federal Reserve also looks to be in a holding pattern for now and recession odds have once again begun to recede. All told, Bloomberg US Corporate High Yield Index yields fell from 7.90% to 7.46% in May, closing at a healthy 121 bps below its YTD high. This grind lower occurred despite pressure on Treasuries. **Although we remain cautious on lower quality credit longer-term, high yield spread compression is an indication of improving economic sentiment and favorable overall market conditions for credit investors.**



Source: Bloomberg

Sources: MMD, Bloomberg, Bond Buyer, CreditSights

PUBLIC SECTOR WATCH

CREDIT NOTES

Bond Market Impact of Moody's US Debt Downgrade

In our recently published piece, we shared our thoughts on Moody's downgrade of the US Government's credit rating from Aaa/negative to Aa1/stable, reflecting accelerating deficit growth and associated borrowing requirements, a fiscal situation exacerbated by recently elevated borrowing costs. Below is our credit team's analysis on the impact of this downgrade on the municipal market.

Municipal Credit Dynamics Differ by Sector and Issuer

Moody's action means that the US Government no longer enjoys a top credit rating from any of the major three agencies. **The effect of this development on the Treasury and housing markets is difficult to predict, although we expect only modest impacts on the tax-exempt bond market.**

While newsworthy, the US Government downgrade was not unexpected as Moody's had changed their credit outlook to "negative" from "stable" in November 2023. At the time, only a handful of public finance issuers were also placed on "negative," and Moody's tempered their analysis by stating that *"few public finance issuers are directly affected (by its then revision of the US outlook change to "negative"). The relatively minor credit impact would also be the case if US credit strength continues to decline and results in a one-notch downgrade."*

S&P was the first to downgrade US credit to AA+ way back in 2011, citing brinkmanship surrounding the debt ceiling. Importantly, S&P made clear distinctions that allow the agency to provide other US-based entities, including municipalities, with a higher rating than the sovereign debt (i.e., AAA). We expect this practice to continue and do not see Moody's current rating action affecting S&P's view of these credits. An example of language that S&P includes in its research reports is excerpted below:

"We rate Greenwich higher than the sovereign because we believe the town can maintain better credit characteristics than the US in a stress scenario, due to its predominantly locally derived revenue base and our view that pledged revenue supporting debt service on the bonds is a limited risk of negative sovereign intervention." S&P Global Ratings, January 17, 2025.

We expect Moody's to afford itself similar leeway as S&P, thereby allowing public finance issuers to have a rating higher than the sovereign. Therefore, those public finance issuers that currently possess an Aaa rating from Moody's are not necessarily at risk of being downgraded. However, there are entities that are directly linked to the US Government's rating, and others that are linked to its underlying federal fiscal standing. Issuers of this nature could see negative rating actions from Moody's.

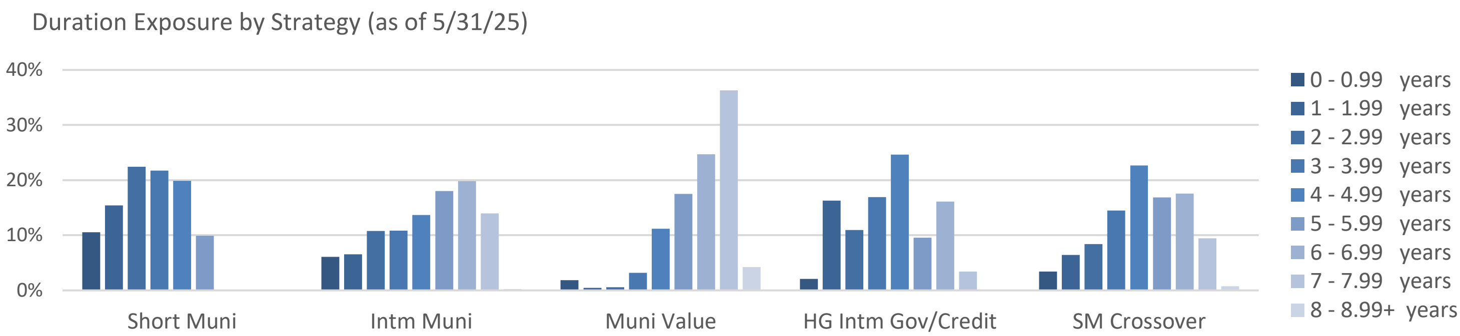
Moody's credit action shines a light on US fiscal conditions but should have a very modest and manageable impact on municipal issuers, and any rating changes will likely be limited to one or two-level downgrades. Most potentially impacted entities have maintained very strong credit profiles for an extended time, and we do not expect that to change. However, we continue to closely monitor municipal bond market trading and, while not expected, any meaningful impact could flow through to borrowers.

Housing	Bonds where there is either a high degree of reliance on FNMA and FRMC insurance on loans, or the Housing Agency owns a large percentage of FNMA or FRMC mortgage-backed securities. Housing bonds that are rated AA+ may still be at risk of a downgrade if Moody's had previously applied a notching mechanism.
Standalone GARVEEs	Based on Moody's current methodology and Appleton's proprietary research, an immediate downgrade of stand-alone GARVEEs (i.e., those not supported by state-derived revenues) in the wake of the US credit downgrade is unlikely. Any change in our opinion would likely be precipitated by a change in Moody's methodology. We also note that stand-alone GARVEEs are already rated multiple notches below the US Government, avoiding potential Moody's "rating cap" implications.
District of Columbia and Metro D.C.	These issuers were very likely already being closely watched by Moody's and other rating agencies, given proposed cuts to Federal spending. We feel one-notch downgrades are quite possible, but do not expect more significant changes.
Pre-refunded ("Pre-re") bonds	Issuers are not required to have their Pre-re bonds "re-rated," but historically, when they did, they received a AAA rating if escrowed proceeds were invested in U.S. Government securities or securities tightly linked to the Federal Government. That will no longer be the case, although we feel municipal market participants will continue to view Pre-re bonds as extremely strong securities. Some issuers may not choose to get their Pre-re bonds re-rated given the US Government's AA+ rating, but we do not expect to see material changes in this corner of the market.

STRATEGY OVERVIEW

COMPOSITE PORTFOLIO POSITIONING (As of 5/31/25)

	Short-Term Municipal	Intermediate Municipal	Municipal Value	High Grade Intermediate Gov/Credit	Strategic Municipal Crossover
Avg. Modified Duration	2.95 years	4.70 years	6.36 years	3.97 years	4.62 years
Avg. Maturity	3.60 years	6.80 years	11.39 years	4.73 years	6.35 years
Yield to Worst	2.98%	3.27%	3.83%	4.47%	3.73%
Yield to Maturity	3.11%	3.52%	4.11%	4.49%	3.86%
Current Yield	4.62%	4.56%	4.65%	4.18%	4.40%



Source: Investortools Perform, Appleton Partners, Inc.

The composites used to calculate strategy characteristics ("Characteristic Composites") are subsets of the account groups used to calculate strategy performance ("Performance Composites"). Characteristic Composites excludes any account in the Performance Composite where cash exceeds 10% of the portfolio. Therefore, Characteristic Composites can be a smaller subset of accounts than Performance Composites. Inclusion of the additional accounts in the Characteristic Composites would likely alter the characteristics displayed above by the excess cash. Please contact us if you would like to see characteristics of Appleton's Performance Composites.

Yield is a moment-in-time statistical metric for fixed income securities that helps investors determine the value of a security, portfolio or composite. YTW and YTM assume that the investor holds the bond to its call date or maturity. YTW and YTM are two of many factors that ultimately determine the rate of return of a bond or portfolio. Other factors include re-investment rate, whether the bond is held to maturity, and whether the entity makes the coupon payments. Current Yield strictly measures a bond or portfolio's cash flows and has no bearing on performance. For calculation purposes, Appleton uses an assumed cash yield which is updated on the last day of each quarter to match that of the Schwab Municipal Money Fund.

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 afford 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.

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