WEEKLY MARKET COMMENTARY

THE WEEK IN MUNILAND

AUGUST 19, 2019

THE BEAT GOES ON

+ Municipal and US Treasury bonds continued to rally as equities remained volatile. For the week, US Treasuries outperformed municipals across the yield curve; US Treasury yields fell as much as 28 basis points while comparable muni yields declined 12 b.p.

+ Despite lagging this week, municipals have outperformed Treasuries for the year and now offer less of an after-tax yield advantage than normal. For one-year-maturity bonds, Treasuries actually provide more after-tax yield than municipals.

  - **Why it matters:** Treasury bonds providing more after-tax yield than municipals is very unusual. Investors should therefore consider putting a portion of their "new" money into one-year Treasuries, which can accomplish three things: 1) increase the after-tax yield of the portfolio, 2) provide a modest amount of recession insurance, because Treasuries have historically outperformed municipals in recessions, and 3) provide "dry powder" to repurchase municipals when they become more attractively priced. Investors who need to sell municipal bonds to invest in US Treasuries should be cognizant of taking too large a capital gain. Too large a gain can outweigh the benefits of moving into US Treasuries.

+ US inflation for July was stronger than expected for the second consecutive month. Core inflation rose 0.3% month over month and is up 2.2% year over year; the latter is the most rapid rate of advance in six months. Given the strength of the labor market, we would expect inflation to push higher at this point of the cycle, but it is too early to conclude that we will see persistent increases in price pressures.

  - **Why it matters:** Rising inflation impacts the value of bond portfolios. We recommend that investors protect their portfolios through tax-efficient inflation protection. This protection is best realized in a fund format through a combination of high-grade tax-exempt municipal bonds and CPI swaps.

+ The most closely watched part of the US yield curve inverted this week for the first time since 2007, suggesting that a recession may be around the corner. We're not convinced that's true.

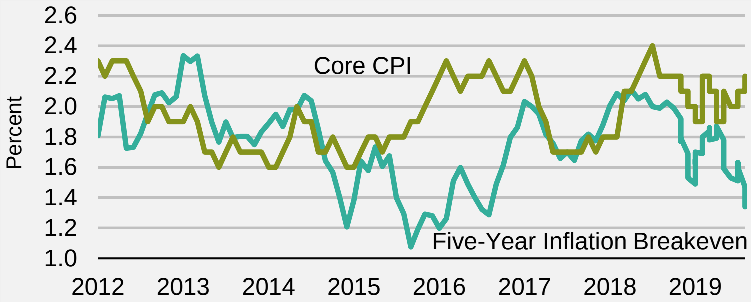
  - **Why it matters:** The US economy has slowed in recent quarters, but the economic data still suggest growth while unemployment remains below 4%. The flattening we've seen in recent months may also be attributable to quantitative easing, which has distorted the long end of the yield curve. The takeaway is that today's inverted yield curve isn't necessarily a recession warning.

POSITIONING FOR TODAY'S MARKET

+ **Credit Risk:** Modest overweight. Investor demand for income remains strong. Economic growth and better-than-expected tax revenues are a credit positive for most mid-grade and high-yield municipal issuers.
+ **Taxable Bonds:** Short- and long-maturity municipal bonds have become relatively expensive; consider adding a position in US Treasuries until municipals are more attractively priced.

Displays of the Week: August 19, 2019

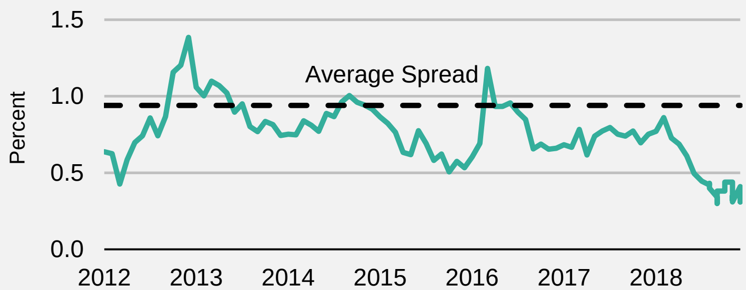
Display 1: Core CPI vs. Five-Year Inflation Breakeven



Break-even inflation rates continue to fall because of increased US-China trade tensions.

CPI through July 30, 2019; breakeven as of August 15, 2019
Source: Federal Reserve Bank of St. Louis and AB

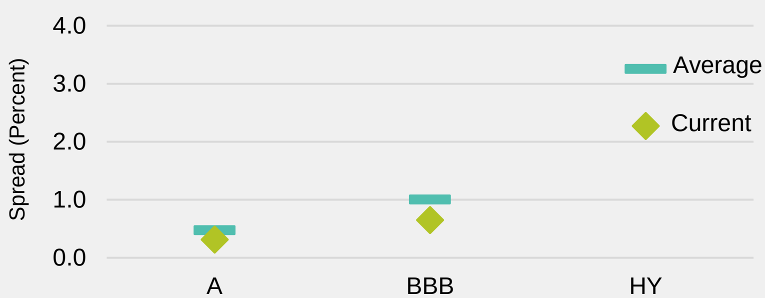
Display 2: Municipal/US Treasury After-Tax Spread



A flight to quality caused the after-tax yield advantage of 10-year AAA municipals to reach 0.33%.

Display shows the after-tax spread of a 10-year AAA-rated municipal bond vs. a 10-year US Treasury.
Through August 16, 2019
Source: Bloomberg and AB

Display 3: Municipal Credit Spreads

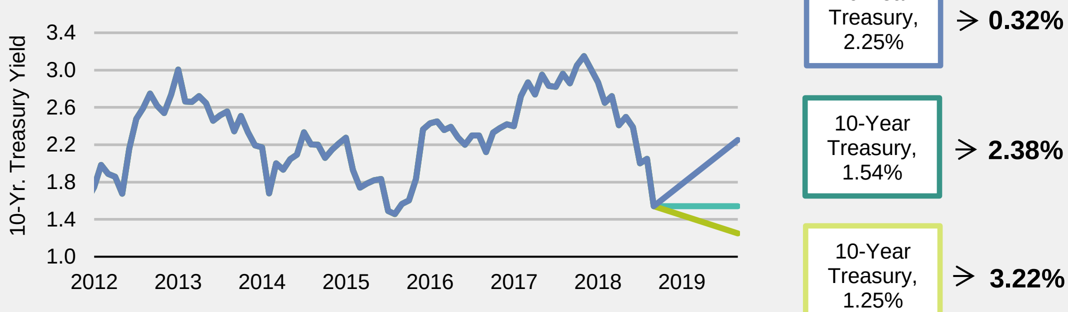


High-yield (HY) credit spreads are through their long-term average, while mid-grade credit spreads are at or near their average.

As of August 16, 2019
Source: Bloomberg, Municipal Market Data and AB

Display 4: Expected 12-Month Municipal Returns Scenario Analysis

10-Year US Treasury Yield (Percent)



Historical analysis does not guarantee future results.
Display reflects expected return of a 5.4-year-duration intermediate municipal portfolio under three scenarios: 10-year Treasury yields rise to 2.25% over the next 12 months, remain the same or decline to 1.25% over the next 12 months.
As of August 16, 2019
Source: Bloomberg and AB

A Word About Risk

Market Risk: The market values of the Portfolio's holdings rise and fall from day to day, so investments may lose value. **Interest-Rate Risk:** Fixed-income securities may lose value if interest rates rise or fall—long-term securities tend to rise and fall more than short-term securities. The values of mortgage-related and asset-backed securities are particularly sensitive to changes in interest rates due to prepayment risk. **Credit Risk:** A bond's credit rating reflects the issuer's ability to make timely payments of interest or principal—the lower the rating, the higher the risk of default. If the issuer's financial strength deteriorates, the issuer's rating may be lowered and the bond's value may decline. **Inflation Risk:** Prices for goods and services tend to rise over time, which may erode the purchasing power of investments. **Foreign (Non-US) Risk:** Investing in non-US securities may be more volatile because of the political, regulatory, market and economic uncertainties associated with such securities. These risks are magnified in securities of emerging or developing markets. **Currency Risk:** If a non-US security's trading currency weakens versus the US dollar, its value may be negatively affected when translated back into US-dollar terms. **Diversification Risk:** Portfolios that hold a smaller number of securities may be more volatile than more diversified portfolios, since the gains or losses from each security will have a greater impact on the portfolio's overall value. **Derivatives Risk:** Investments in derivative instruments such as options, futures, forwards or swaps can be riskier than traditional investments and may be more volatile, especially in a down market. **Leverage Risk:** Trying to enhance investment returns by borrowing money or using other leverage tools magnifies both gains and losses, resulting in greater volatility. **Municipal Market Risk:** Debt securities issued by state or local governments may be subject to special political, legal, economic and market factors that can have a significant effect on the Portfolio's yield or value. An investor cannot invest directly in an index.

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