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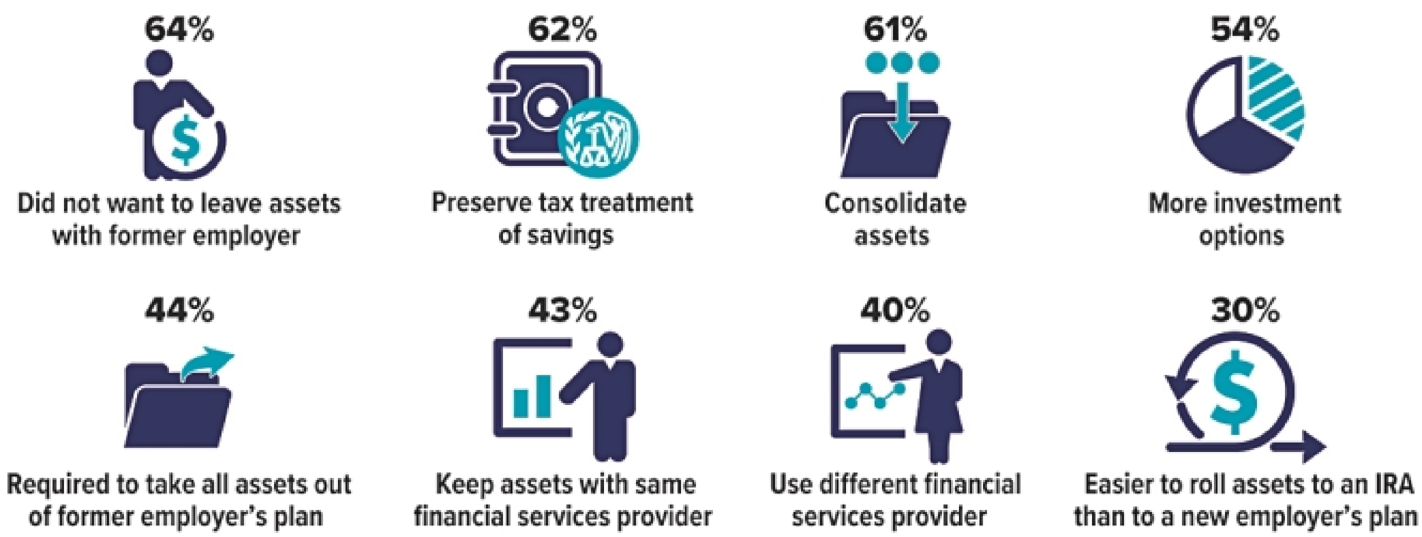
Be sure to check out John Stewart's article, " **Debt Ceiling Dram** a" below!

Reasons to Roll

When you leave your job or retire, you have an opportunity to manage your funds in an employer-sponsored retirement plan such as a 401(k), 403(b), or government 457(b) plan. Depending on the situation, you generally have four options.* The approach that typically gives you the most control over the funds is to transfer some or all of the assets to an IRA through a rollover.

Three out of five households who owned traditional IRAs in 2022 had executed at least one IRA rollover from an employer-sponsored retirement plan. These were the top reasons for the most recent rollover.



*Other options may include leaving assets in the former employer's plan, transferring assets to a new employer-sponsored plan, or withdrawing the money.

Source: Investment Company Institute, 2023 (multiple responses allowed)

Debt Ceiling Drama

At the beginning of the year the consensus narrative was that the first half of the year was going to be challenging. There were predictions of a recession and downward pressure on stocks and other risk assets early in the year followed by a recovery of both the economy and stock market in the second half of the year. Around that time, we suggested that the opposite was actually more likely – that is, the economy and stock market could remain resilient longer than most expected, but risks could grow as we move into the second half of the year. So far, the overall stock market has indeed been quite resilient thus far in 2023 even though there have been pockets of weakness, most notably the recent turmoil in the banking sector. It is in fact true that several of the largest technology companies have done the heavy lifting for the S&P 500 index this year given that the equal-weighted S&P 500 index is basically flat year-to-date. Nevertheless, as the markets overall have outperformed most investors' expectations, we are starting to see a shift in sentiment toward a more sanguine outlook. While there is still a significant amount of bearishness among market participants, the conviction level among that cohort has waned while the bulls have become more emboldened and the neutral crowd is starting to lean more toward the optimistic end of the spectrum. Could this be setting the stage for a negative surprise in the second half of the year as risk returns to the market paradigm?

The political theater surrounding the debt ceiling situation has yet to reach its most dramatic climax, but the actors involved are preparing to give their best to convince us that what we're seeing is real. Nevertheless, we've seen this movie before. There may be some serious hand-wringing and 11th-hour meetings involved, but we will ultimately come to some sort of resolution. A short-term stop-gap measure may buy our fearless leaders more time, which would result in this production lasting far longer than any of us would like to see.

The story that isn't being told, however, is how the debt dynamics are affecting interest rates and ultimately the stock market. Since we've been at the statutory debt limit since late January, there has been no net new issuance of Treasury securities since that time. Meanwhile, deposits seeking higher rates have flooded the short end of the Treasury yield curve. This has depressed yields for maturities from six months to two years, making it look like the market is anticipating Fed rate cuts when in actuality it is being driven by simple supply/demand dynamics. When the debt ceiling is finally lifted, the new supply of Treasuries could push interest rates significantly higher – throwing a wrench in the mega cap growth rally that has been built on the foundation of falling interest rates going forward.

Therefore, we are reducing large capitalization growth exposure in our portfolios while adding a position in small caps, which are trading at the biggest discount to their larger brethren in over 20 years. We also continue to maintain defensive positions in sectors like utilities and consumer staples given our expectation for more market volatility as we move through the balance of 2023.

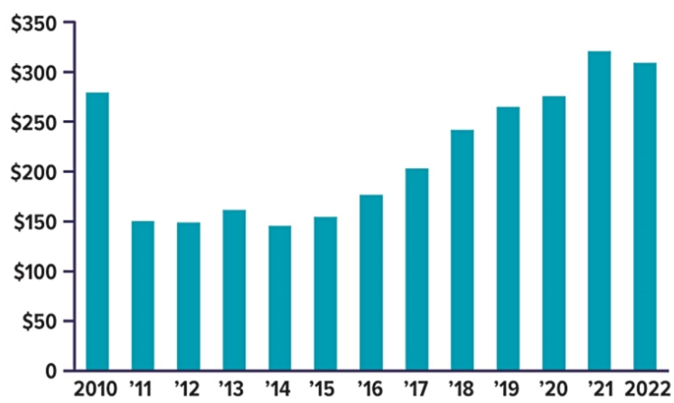
Municipal Bonds: A Tax-Advantaged Way to Put Capital to Work

Municipal bonds are issued by public entities such as state and local governments, health systems, universities, and school districts to help finance the building and maintenance of infrastructure projects such as roads, airports, water systems, and facilities. Despite the higher borrowing costs that resulted from the Federal Reserve's inflation-fighting interest-rate hikes, municipalities issued $308 billion in debt in 2022 to fund capital projects, after selling more than $321 billion in 2021.[1]

At present, many municipalities are in solid financial shape, due to an influx of pandemic stimulus funds and increased income and property tax revenues. Over the longer term, a federal infrastructure bill passed in 2021 is expected to provide additional money for capital projects and help boost municipal credit quality.[2]

This means that investors might be able to tap into the higher yields being offered on muni bonds without taking on greater risk. The yield on the Bloomberg Muni Benchmark 30Y Index, a common benchmark, rose to 3.6% at the end of 2022, after starting the year at just 1.5%.[3]

Municipal bonds issued for new projects, in billions



Source: Refinitive, 2023

Accounting for Taxes

The interest paid by municipal bonds is generally exempt from federal income tax, as well as from state and local taxes if the investor lives in the state where the bond was issued. For this reason, muni bonds and tax-exempt funds have long been a mainstay in the portfolios of income-focused investors who want to manage their tax burdens.

The taxable equivalent yield is the pre-tax yield that a taxable bond must offer for its yield to be equal to that of a tax-exempt muni bond. Tax-free yields are often more valuable to investors in higher tax brackets, and they have become especially appealing in high-cost states now that the federal deduction for state and local taxes is limited to $10,000 a year.

For example, a 5% tax-free yield is equivalent to a taxable yield of about 7.9% for an investor in the 37% bracket and 6.6% for an investor in the 24% tax bracket. Exemption from state income taxes would increase the equivalent yield.

Investors should keep in mind that capital gains taxes could still be triggered if tax-exempt bonds or fund shares are sold for a profit. Also, tax-exempt interest is included in determining whether a portion of any Social Security benefit received is taxable. Some muni bond interest could be subject to the alternative minimum tax.

Reviewing the Risks

Because government entities have the power to raise taxes and fees as needed to pay the interest, muni bonds generally carry lower risk than corporate bonds. From 1970 through 2021, the 5-year default rate for U.S. municipal bonds was 0.08%, compared with 6.8% for global corporates.[4]

Regional economies and the financial strength of issuers can vary widely, so municipal issues are rated for credit risk, as are other bonds. A credit rating ranging from AAA down to BBB (or Baa) is considered "investment grade"; lower-rated or "high yield" bonds carry greater risk.

As interest rates rise, bond prices fall, and vice versa. When redeemed, bonds may be worth more or less than their original cost. Bond funds are subject to the same inflation, interest-rate, and credit risks associated with their underlying bonds. The return and principal value of bonds and mutual fund shares fluctuate with changes in interest rates and other market conditions, which can adversely affect investment performance.

The performance of an unmanaged index is not indicative of the performance of any specific security. Individuals cannot invest directly in any index. Past performance is no guarantee of future results. Actual results will vary.

Mutual funds and ETFs are sold by prospectus. Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional. Be sure to read the prospectus carefully before deciding whether to invest.

1) Refinitiv, 2023

2) *The Wall Street Journal,* November 15, 2021

3) Bloomberg.com, November 30, 2022

4) Moody's Investors Service, April 21, 2022

A Mortgage Recast Is an Alternative to Refinancing

If you would like to reduce your monthly mortgage payment without having to refinance, then you may want to explore a mortgage recast. When you recast your mortgage, you put money toward the principal balance of your current home loan. Your mortgage lender then recalculates (reamortizes) your loan based on your new, lower balance, which reduces your monthly payment. Your interest rate and the number of years remaining on your loan stay the same. Here are three scenarios where a mortgage recast might be especially appealing.

- You have extra cash on hand, perhaps from a bonus or an inheritance. It's sitting in a low-yield account.
- You are close to retirement or retired. You want to keep your home but lower your monthly expenses.
- You bought a new home with a smaller down payment than you intended because your old home is still on the market. But once your old home sells, the proceeds can be applied to your new mortgage through a recast.

Refinancing your mortgage may be a better option if your goal is to pay off your loan faster by shortening the term, or if you want to lower your interest rate or obtain cash. But if your objective is simply to lower your monthly payment and save on interest charges, then recasting your mortgage may be appropriate.

Recasting is generally simpler and less expensive than refinancing because you're keeping the same mortgage instead of applying for a new one. It doesn't require an extensive application, a credit check, a new appraisal, or closing costs, though you typically will need to pay a processing fee.

Check with Your Lender

Not all mortgage lenders offer recasts, and some types of loans, including FHA, VA, USDA, and certain jumbo loans are not eligible for recasting. If you do qualify for a recast, your lender will give you more details about the process.

You may be able to recast once you've increased your equity by making extra payments or by paying a lump sum toward your mortgage balance. Minimums vary, but the additional principal required may be as little as $5,000. Of course, the more you put toward your principal, the lower your future monthly mortgage payment. If you are currently paying principal mortgage insurance (PMI), putting a lump sum toward your mortgage may help erase that, further lowering your monthly payment.

One drawback of a mortgage recast is that it could tie up money you might need later for other purposes. To access your equity in the future, you may need to refinance, take out a home equity loan, or even sell your home.

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