APRIL 30, 2020

UPDATE ON THE HIGH YIELD MUNICIPAL BOND MARKET

Volatility Continues but Market more Orderly
A Pricing Issue, NOT a Credit or Default Problem
The Strategy is Solid Credit-wise and should Rebound
Income Remains Attractive
Patience, Patience, Patience

As the coronavirus continues to unfold and hopefully peak, we pray that you and your families remain safe and healthy. We wanted to share this update with you on the high yield municipal market and our portfolio as it relates to the Principal Street Tax Exempt High Income Strategy (the "Strategy").

THE MARKET

As we all know, the high yield market fell hard in early/mid March, triggered by a massive move by the market to find liquidity. As painful as the drop has been, we do see some positive elements emerging.

We believe the following; that:

- The bottom of our market occurred in the latter part of March. Although we continue to see selling pressure and at best a "sideways" market of late, the market has been much more orderly.
- This event is all about liquidity and pricing, and not about credit or income.
- Tremendous value has been created as a result of the falling prices.
- The market is poised for a rebound, but not immediately.

Historically, the high yield market has been slower to rebound than the investment-grade market and can generally be traced first with shorter-term maturity investment-grade, then intermediate maturity investment- grade, then longer maturity investment-grade. High yield will generally lag, but if history is any lesson, the rebound should be swift and dramatic when it occurs.

THE STRATEGY

Although valuations/performance is down because of the liquidity/pricing dislocation, this has not been a credit or default issue. It is worth repeating that the Strategy is fundamentally sound, constructed with bonds that are typically:

- Senior-secured positions;
- Bricks-and-mortar physical assets that have underlying collateral value; and
- Essential needs and services.

We have spent a tremendous amount of time re-analyzing our credits in light of the coronavirus and the economic shutdown. We do not purport to have all of the answers, but we do believe that the structure of the portfolio should serve us well over the longer term. The vast majority of our projects continue to operate, and we anticipate that those operations will remain viable. In the early days of the pandemic, we were especially concerned about the senior living sector, in general. Perhaps counterintuitively, this sector has emerged as something of a “safe haven” for both residents and investors. In addition to providing essential services to the senior population, the majority of senior living facilities have initiated very stringent safety protocols and continue to operate. In our view, they may attract even more seniors who have been isolated once the coronavirus lifts.

Despite the viability of the projects, it is important to note that the price dislocation and sell-off has not discriminated between sectors. No sector has been immune, from senior living/healthcare to education to manufacturing, and from established projects to older projects, stronger projects to more challenging projects, as well as construction to projects in capitalized interest.

The Strategy’s primary objective remains as it has always been, i.e. to maximize income, and this effort continues unabated. The majority of the portfolio projects continue to operate and generate income, which in turn provides tax-free income for our investors.

SUMMARY / OUR VIEW

The heightened volatility in the market continues to be one of liquidity and pricing rather than credit and income generation. As a result, we have seen a very broad swath of credits that are dislocated from their underlying value to the point of being irrational, much like what occurred in 2008. In many ways this sell-off has been even swifter and more severe, but in both instances, there was a break between pricing and credit, and this has created tremendous value.

We do expect pricing to normalize, and the market is already much more stable than just a month ago, albeit at lower prices. Consequently, we continue to see tremendous value at these price levels and long-term investors may want to consider adding to their portfolios. New money is likely to experience significant capital appreciation over the next 12-18 months while receiving attractive tax-exempt income.

As our country starts to re-open, we believe the economy will begin to pick up in the late 2nd-3rd quarter. There is “light at the end of the tunnel”, and with that, a likely attractive rebound for our market as investors once again seek yield and come to understand the value that has been created..

In our opinion, patience, as difficult as that can be, is the best remedy, but also keeping an eye toward taking advantage of the discount prices that our market has presented.

As always, we are here to help with questions and clients.

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