ANNUAL OUTLOOK

2020 – Politics, Climate Change & Angry SWANS

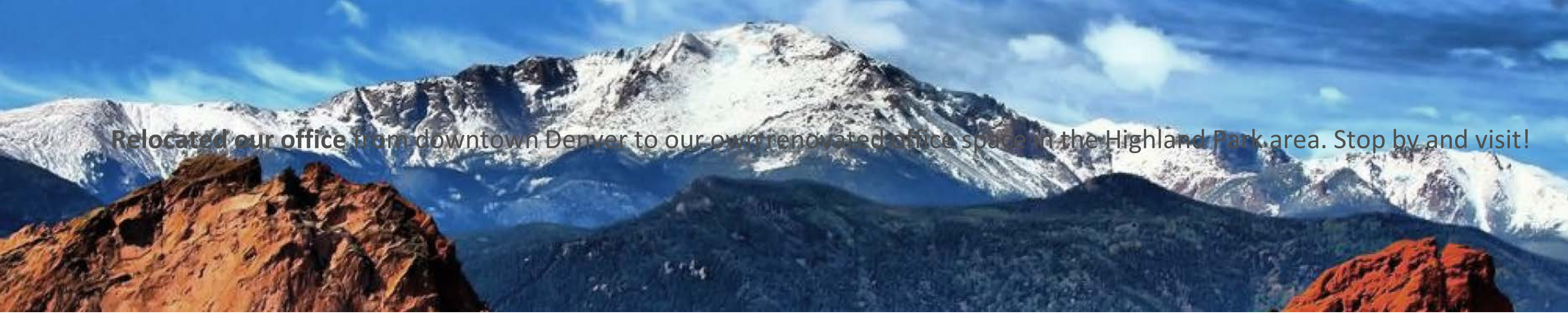
MAINLINE WEST

Muni Market Overview 2020:

Munis have remained fundamentally and technically strong through recent years. Will 2020 be another year for top performance? Like other asset classes, MainLine thinks performance in 2020 will be limited. We will proclaim it a good year if you can get your coupon and have neutral price performance by year-end. We see some looming "dark clouds/angry SWANs" not priced into the market that could cause turbulence (but also opportunities) for those who see past the headlines and know "muniology". We are seeing the following developing "dark/angry" themes in 2020 and beyond:

- **Climate Change Concerns.** This is a 30-year risk that environment-friendly operational changes instituted today could have an economic impact on the credit quality of certain muni issuer and pricing spreads when purchasing long-term bonds.
- **Political Strife and the 2020 Presidential Election.** Remember the market's reaction when Trump was unexpectantly elected? We think the temperament of the nation with DC and with each other is even hotter today. Things could get ugly this fall.
- **Illinois Agenda**. Politics and lawsuits challenging the issuance and repayment of bonds that may not be perceived for the public good was introduced in 2019. This agenda, being politically motivated, could gain copycats and grow going forward.

Will these concerns come into focus into the muni market in 2020? We will be preparing our investors' portfolios and monitoring them to be ready when they do. Otherwise, the *consensus view is a year of coupon return.*



Muni Market Performance Recap 2019:

- One again, munis proved to be a good late-cycle performance haven. After adjusting for taxes, munis trailed only US Corporate bonds on a total return basis using Bloomberg/Barclay's indices. Here are the final 2019 total returns:

Bloomberg/Barclays Index	Coupon Return	Price Return	Total Return (2)
Muni Composite	4.18%	3.26%	7.54%
Muni Composite (3)	7.71%	3.26%	10.97%
US Treasury Composite	2.43%	4.43%	6.86%
US Agency Composite	3.31%	5.61%	8.92%
US Corporate Composite	4.02%	10.33%	14.35%
Global Aggregate (1)	2.53%	4.33%	6.86%

(1) Invested in a GDP weighted portfolio of Global government and non-government issuers
(2) Returns are not including reinvestment.
(3) Adjusted coupon return for the following taxes: 37% Federal Income, 3.8% Obama Medicare, 5% average state income tax.

2019 Highlights in Muniland:

- Muni supply & demand were both up big in 2019, with demand winning the race.
    - Issuance up 18% (roughly $56 billion), led by refunding up 40% due to taxable advance refunding.
    - Positive inflows into muni funds every week after the first week of 2019. Roughly, $85 billion new money went into munis in 2019 versus a $5 billion increase in 2018.
    - SALT has provided further need for tax-exempt income from high income tax states, which has also increased demand.
- Interest rates ended lower at year-end as the Fed eased three times in the second half of 2019. Ten-year Treasury yields were down roughly 100 bps, followed closely by munis at 85 bps. The correlation of munis is much stronger than historically and reflects an 85% move, versus an expected 60%. *This shows the increased appetite for munis and explains the impressive after-tax performance.*

2019 Highlights in Muniland (cont'd):

- Positive news on muni credit quality continues:
    - *For the ninth quarter in a row, muni credit rating upgrades outpaced downgrades according to Moody's.* Moody's has upgraded 148 ratings, versus downgrading 78 ratings.
    - Problem states like New Jersey, Connecticut, and Illinois are all trading with tighter yield spreads to the AAA-curve, due to expectations that credit quality is improving.
    - According to a recent report from the National Association of State Budget Officers, ***state*** *budgets are growing at the fastest rate since the recession (2009)*. Budgets swelled 5.9% in 2019, following a 3.7% increase in 2018.

2019 Highlights at MainLine West:

- **MainLine West Tax Advantaged Opportunity Funds have become GIPs certified**. The GIPS standards are a set of standardized, industry-wide ethical principles that guide investment managers and asset owners on how to fairly calculate and present their investment results. The goal of GIPS is to promote performance transparency and comparability.
- **$100+ million of capital was raised for MainLine West Tax Advantaged Opportunity Fund VI**, and $10 million was deployed.
- **Relocated our office** from downtown Denver to our own renovated office space in the Highland Park area. Stop by and visit!

Muni Market Overview 2020:

Market supply estimates range from $410 to $450 billion. This will put the market back to the record levels of 2016 and 2017. This supply, combined with expected lower demand, has the muni market primed to have "excess supply" for the first time since 2017 from $25 to $50 billion.

In 2020, MainLine is expecting a softening economy, no inflation concerns, and the continued long-term demographics that will keep interest rates low. In 2018, we felt the argument for higher rates in the future was not a strong one and still feel the same way for these various reasons.

- *Demographics* – The aging population and its need for fixed income investments and slower GDP growth.
- *Inflation will remain tame.* Technology is and will continue to keep prices down (i.e. labor costs). The use of robots will continue to grow, as well as, aggregation of services and products (i.e. Amazon).
- *Low rates internationally will keep US rates down.* Until rates overseas increase, the US fixed income market will continue to attract money, and this demand will dampen any upward pressure on rates.

Going forward, investors need to plan for lower investment returns:

It is time for investors to stop wishing and waiting for the old days of higher fixed income rates. *Due to the reasons listed above, interest rates will remain low historically for years to come.* MainLine feels investors need to be prepared for lower returns for all assets classes going forward. The days of 5% yields in munis are long gone and, only in a major market dislocation from taxables, will the possibility of 4% yields be available again. *We believe opportunistic, long-term portfolios can earn a 3.25% to 3.50% yield, going forward.* Does this mean an investor will be earning 1.50% less in income (roughly $15,000 less in annual income per $ 1 million invested)? No!

The Impact on Income at Lower Yields – A reality, but muted by low inflation.

To evaluate how much income an investor is really losing by investing at lower yields we need to look at yields after adjusting for inflation and taxes and then compare it historically. Below is a rough calculation on the tax adjusted real rate of return for a municipal bond over the last 20 years, and current levels. This analysis assumes the investor holds the bond for 10 years earns the book yield, pays the average top Federal income tax and average state income tax rate plus Obama Medicare tax since 2013.

10 Year Period	Avg Invest Yield (1)	Avg Inflation	Top Fed Inc Tax (2)	Avg State Inc Tax (3)	Total Inc Tax	Real Rate of Return (4)	Real Rate Tax Adjusted	Annual Income per $1 mln	Annual Income Lost
2000-2010	5.00%	2.54%	36.07%	4.00%	40.07%	2.46%	4.11%	$41,065	$0
2010-2020	4.00%	1.78%	40.36%	5.00%	45.36%	2.22%	4.06%	$40,630	-$435
2020-2030	3.50%	1.50%	40.80%	5.00%	45.80%	2.00%	3.69%	$36,900	-$4,165
Notes:									
(1) Based on the Bond Buyer 40 index.									
(2) Includes Obama Medicare Tax of 3.8% since 2013.									
(3) Assumes average top state income tax rate has not changed at 5% since 2010, was 4% prior.									
(4) Bond return less inflation rate = real rate. Assuming the yield is the only component of return.									

The true loss of income for a muni investor receiving a 5% book yield from 2000-2010, versus the new 3.50% yield, is roughly 42 bps, or $4,165 in income per $1 million par annually. ***Yes, this is a loss of income, but on a tax and inflation adjusted basis, not as bad as the 150 bps many would think ($15,000 in annual income).*** Compare this with the income loss by staying in cash (waiting for the 5% or 4%) and it seem reasonable. Let MainLine get that cash to work when the opportunity arises in 2020!

What about these “dark clouds” forming over the muni market? *They have the possibility to shake the foundation of the municipal market, but with proper bond selection, diversification, the impact on a MainLine West investor will be muted, and could create an investment opportunity.* Let us review what these angry SWANs are.

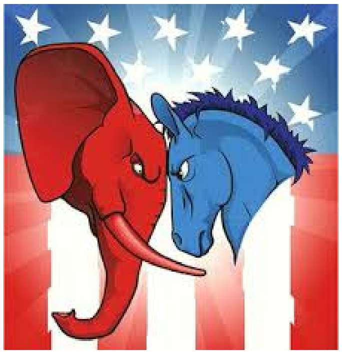
Climate Change and Munis:

Unfortunately, it seems most people’s opinions on climate change/global warming is from their political affiliation, or what news channel they watch. I am not going to cite evidence either way on whether it is real or not. *Simply put, if it is happening - even modestly, the impact on the environment, economy, and society would be adversely negative on certain markets, regions and services around the world.* Yes, this also means the safe SWAN world of munis.

Assessing climate change needs to become a much bigger factor when researching and purchasing bonds. *We anticipate, at some point, an analyst or organization will sound the alarm that climate issues will spell the potential doom of the municipal market.* It will become the new “4 letter word” in muni land, like pensions and rising healthcare costs.

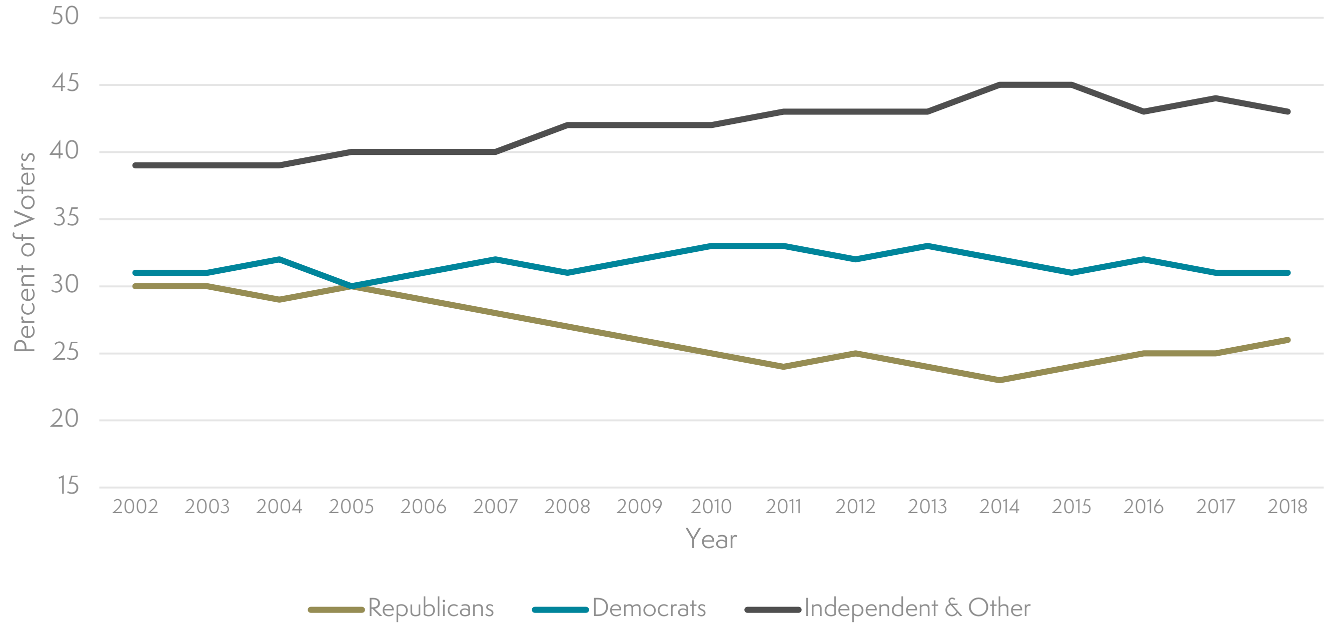
MainLine feels there will be some “added heat” to the muni credit process. There will be troubled spots, there will be troubled issuers, but there also will remain SWAN investments. *MainLine, as a long-term buyer of munis, is now becoming more selective of an issuer’s location, use of proceeds, regulatory risks, technology changes, and statutory claims, as climate control becomes an important risk factor when buying bonds.* These are what we call “transitional risks” which begin today, before the “physical risk” which could occur in 30 years.

We plan to explore this topic in greater detail in the January 2020 municipal market credit review and plan to report your portfolio’s exposure to climate change risk this summer in your semi-annual report.



MainLine is getting the feeling that the 2020 election could be ugly to the markets, economy, and the American spirit. Staying divided between the three branches of government may be the best news the markets could receive in the fall. While the disenchantment of voters with the policies and practices in DC is not new, it is growing and could ultimately lead to change. The 2020 Presidential election will likely shed a light on the discontent, which could add uncertainty to the markets.

History tells us that there is a fine line between being a protestor and a patriot. We also know the Constitution gives us the right to abolish or alter the government when the will of the people is not being met. We are not predicting another civil war, but most likely, some instability, uncertainty, and an evolution of a different way of thinking than what the two parties are giving us today. ***America is seeking a third option and 2020 may be the year this becomes a market concern.***



The graph above highlights the rise of party affiliation other than Democratic or Republican. As of 2018, 43% (up from 39% in 2002) are independent or belong to another non-traditional party. On a positive note, the American system/politics was designed for conflicts. Some of our best changes and ideas have come at the peak of these conflicts. The trend continues to point to change at some point. It didn't happen after 2016, might it happen after 2020?

MainLine believes in the need for essential services to be provided by the government. This is important when it comes to American politics and any ramifications that could come out of the 2020 election process. *So much could happen over the next eleven months, but essential services will not change.*

"The Illinois Agenda":

Politics and legal interpretations are starting to challenge bond deals and the process taken to issue these deals. A court case in 2019 lead by a "politically motivated" counterparty challenged the legal ability to issue debt by the State of Illinois. The case was weak, and has been dismissed, but it highlights the agenda that issuers may face, and those who disagree with them. Illinois is not the first, and we fear there will be more going forward. We see the same underlying themes with Puerto Rico, Detroit and the Platte Valley bankruptcies. It also aligns with our concern of the decline in the gold standard of general obligation bonds and the claim on tax revenues after political engineering and inconsistent legal interpretations.

Going forward, we are cognizant that special interest groups will likely copycat the type of lawsuit that occurred in Illinois and test the issuing practices of municipal bonds. We are concerned about the credit quality on limited general obligation, appropriated, and unlimited GO's not issued under the proper procedures and in weakening demographic regions.

MainLine feels the SWAN (Sleep Well at Night) theme remains for the right type of bonds, the market may only get a bit angry along the way. There should be not concern about muni bonds issued for essential services, backed by the right type of revenue, with the right type of indenture from a solid demographic region. In the end, the fundamentals of the muni market will be reinforced and better defined because of the "Illinois Agenda", much like how the AAA-rated monoline insurers disrupted the market from 2008 to 2010. The morally, structurally, and politically "weak" deals will be highlighted and ultimately eliminated by the market. This will only make the muni market stronger and safer.

2020 Conclusions:

The municipal market has been sound, fundamentally and technically, for quite a while now. We feel this has been justified, and it is realistic to think it will continue. The expectations for 2020 are for investors to collect their coupon and have marginal price change. However, MainLine does feel 2020 could become challenging with some of the "angry SWANS" we are seeing on the horizon increasing muni volatility. If so, there will be some issuers and types of bonds that are no longer in favor by the muni market and there could begin a segregation between long-term SWAN bonds and "angry ex-SWANS".

Similar to what happened during the demise of the AAA monoline insurers from 2008 to 2010, MainLine will continue to work diligently to make sure your portfolio is not the "angry" one.