MONTHLY REVIEW

March 2019

MAINLINE WEST

March 2019 Muni Market Monthly Report – "Fund Spotlight"

The muni market outperformed taxables during the month of March. This is unusual, as the muni market rarely outperforms taxables in a strong rally. Muni issuance remains below long-term levels, inflows remain positive and credit news seems encouraging, fueling munis to possibly be in an over-bought position for the moment. We are looking for a slight cooling off before what could be a strong summer of performance.

In this month's Municipal Credit Review, we put a spotlight on the Funds. As we are talking with investors about Fund VI, one of the topics that is usually discussed is what NAV volatility should be expected, and what is the probability we will need to call the 30% deleveraging capital. We cannot guarantee when (and if) it will be needed, but we can look at the history of NAV changes and estimate when it is most likely to be called and why.

Muni Market Review

Last month, the muni market had the largest rally since 1990, with price gains exceeding 2.2% according to MMA (Muni Market Analytics). Munis outperformed taxables, as concerns with the Fed are now leaning back to a possible easing in late 2019, and some overseas bond markets returned to negative yields. More specifically:

- Muni yields decreased from 10 to 38 bps with the curve flattening 28 bps.
- Taxable yields decreased from 29 to 30 bps with the curve remaining unchanged.
- Year-to-date, muni issuance remains low versus the last five years (-29%), but now up slightly from 2018 (15%). This low issuance, combined with eleven straight weeks of positive cash flows, is fueling strong muni performance.
- The 7-day muni floating rate index traded at roughly 60% of 1-month Libor. The average is 70%; current levels show the strong demand for money market investments from the cash flows into munis. At some point, this will be invested into the muni market.

Muni Market Review (cont'd)

We do not envision munis continuing their strong current performance without taking a step back first. We look for a slight sell-off over the next 30 to 60 days that could provide some opportunities. After that, we feel technicals will drive the market back to outperformance over the summer months.

On a relative value basis, munis are now considered rich versus taxables, except on the long-end where they still have a little value.

Market News and Credit Update

- The data is coming in, and people are voting with their feet. *High tax states are losing their battle to keep residents.* States with an income tax rate higher than the 5.55% average has had outmigration of over 2.3 million versus those with below average tax rates that have had immigration of 2.3 million. The impact of this will be felt with Federal aid and, at some point, in congressional seats. States like California, New York and New Jersey led the way in outmigration. States like Florida and Texas lead the way with immigration.
- According to BAM/ML research, top and bottom five states for personal income growth in 2018 were:
    - *Top -* Washington, Utah, Colorado, Nevada, Arizona
    - *Bottom-* Kentucky, Rhode Island, Vermont, Nebraska, Hawaii
- *Illinois' proposed budget plan is focused on instituting a progressive income tax to increase revenue.* They will then issue bonds and invest the proceeds to lower its pension liability, hoping investment returns outpace borrowing costs and invest return benchmarks. Both are speculative bets, and have analysts mixed on their outcome.

MAINLINE WEST FUND SPOTLIGHT – NAV Volatility and The Need for The 30%

Introduction:

Definition: Fund NAV (Net asset value) is calculated by dividing the gain or loss on the Fund's investment by the capital invested by the Fund. NAV is the unit price of a subscription in the Fund, and begins at $1.00 and then changes depending on whether the value of the investments go up or down. For example, if the muni bond prices go down more than swap values go up, the NAV could be $.90. If muni prices go up more than the swap values go down the NAV could be $1.10.

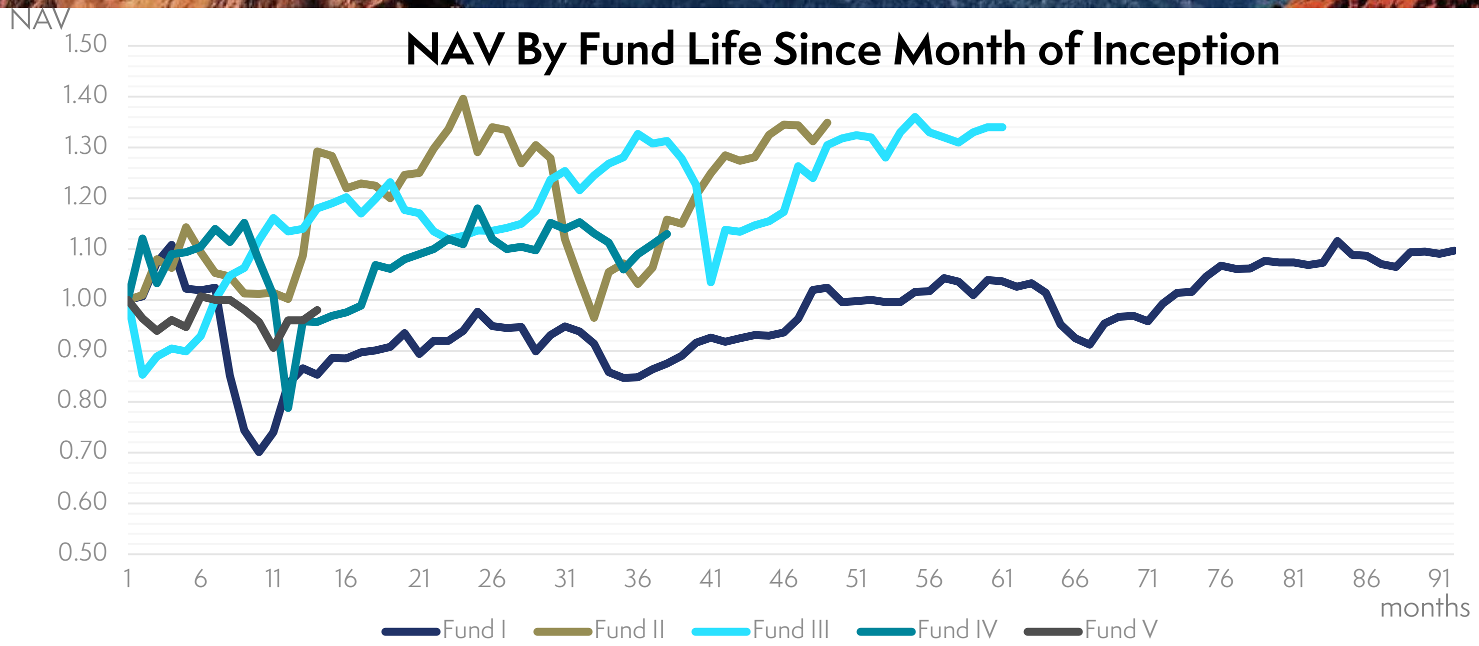
The Opportunity Funds, through the use of leverage, pay out high current tax-exempt income but, with this advantage, the NAV for the Funds can be more volatile than the price change of a bond. ***MainLine is not as concerned with the day-to-day volatility of NAV for performance purposes, but more so to monitor capital levels and the possibility of calling the 30% deleveraging that is required to be held by each investor to meet reserve requirements if prices go down too much.***

MainLine has only had to call deleveraging capital once. It was for Fund I approximately 8 months after its inception, when Lehman's bankruptcy rattled the markets. Yet, it is a necessary safety net that is always there - even if it is not needed. We can never guarantee we will not need it, and we reserve the right to call the capital at any point during the Fund's life. We hope this spotlight will educate our investors regarding the probability and the most likely time that capital may be called.

Analysis:

An easy way is to show NAV risk is to chart out the volatility of it on a monthly basis for each Fund according to its month since inception. We have five Funds with monthly NAV history to review and feel the information tells a pretty good story about the Funds and the "NAV risk".

- **Analyze NAV volatility:**
  - The chart on the next page shows the month-end NAV per fund by month since inception. The rough calculated NAV were the 30% deleveraging capital will begin to be needed is $.70 to $.75.
  - The data points in the analysis are month-end. MainLine tracks the NAV daily and, in some cases, the minimal and maximum have been different than the month-end NAV's used in the analysis.



	Fund I	Fund II	Fund III	Fund IV	Fund V	Fund Avg
Life of Fund						
Avg Absolute % Nav Chge	2.34%	3.69%	2.80%	4.00%	2.66%	3.10%
Min NAV	0.70	0.97	0.85	0.79	0.91	0.84
Max NAV	1.12	1.40	1.36	1.18	1.01	1.21
First Year of Fund						
Avg Absolute % Nav Chge	6.98%	2.71%	4.63%	6.94%	2.96%	4.84%
Min NAV	0.70	1.00	0.85	0.79	0.91	0.85
Max NAV	1.11	1.14	1.16	1.15	1.01	1.11
After First Year of Fund						
Avg Absolute % Nav Chge	1.70%	3.98%	2.39%	2.75%		2.71%
Min NAV	0.85	0.97	1.04	0.96		0.95
Max NAV	1.12	1.40	1.36	1.18		1.26

Observations:

- *NAV volatility is highest in the first year of a Fund's life.* On average, NAV changes 4.84% monthly over the first year of the Fund's life. After the first year, it changes at only 2.71%.
- Only Fund II showed higher monthly volatility after the first year at 3.98% versus 2.71%.
- Over the life of the Fund, monthly NAV changes averaged 3.10%.
- Using the NAV of $.70 as the benchmark for deleveraging, the monthly plots above shows the need for Fund I was in its eighth month.
- The second lowest NAV plot was Fund IV at an NAV of $.79 in month #12

Conclusion:

- *The data shows that the greatest chance for the need for the 30% is highest in the first year of the Fund.* This makes financial sense, as the duration of the bonds and swaps are at their highest and, therefore, any changes in interest rates will create a bigger change in NAV.
- Fund NAV history shows a minimal NAV of $.70, and a maximum pf $1.40, and a pretty steady 2% to 4% average monthly volatility.

We cannot guarantee that the Funds will not require deleveraging capital after the first year. It can be said that, with each passing year, the risk does lessen. *MainLine manages the Funds such that it would take a major market dislocation to require the use of deleveraging capital (a two standard deviation market move which has a 5% chance of occurring).*

By using this risk management target, and the 30% available reserves, MainLine feels it is being prudent in protecting your capital.