CARRET Asset Management

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Carret Credit Insight

The Decade of Globally Coordinated Monetary Stimulus

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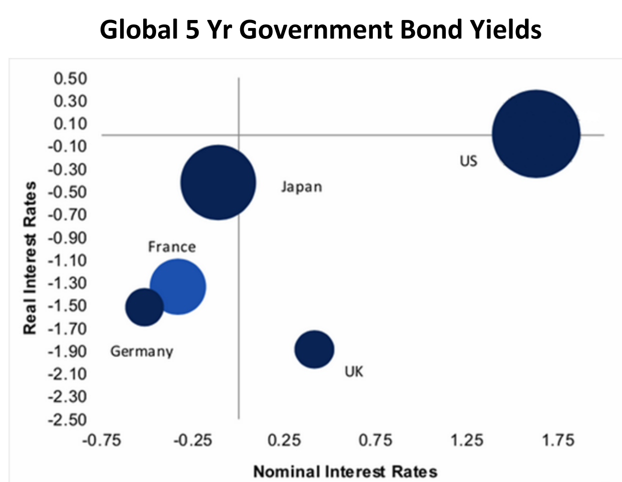
Firm AUM

$2.966 Billion

We wish you health, wealth, and happiness in the new decade and what an interesting decade the passing one was. In hindsight, we started 2010 with a hangover inflicted from the financial excesses that led to the Great Recession. During the 2010s, the economy expanded at a moderate, but extremely stable growth rate, with GDP averaging 2.3%. The unemployment rate began the decade at 9.9% and declined steadily to a 50-year low of 3.5% to end the decade. The consumer (2/3rds of the economy) led the expansion while business investment and government spending contributed more modestly. On January 1st, 2010, the 10 Yr U.S. Treasury opened the decade at a yield of 3.83%. Three thousand six hundred and fifty-one days later, the 10 Yr Treasury closed the decade at a yield of 1.92%. During this ten-year period, the highest yield on the 10 Yr Treasury registered 3.99% (April of 2010) and hit a low of 1.36% (July of 2016). Eliminating the two tails, rates were range-bound between 1.70% - 3.19%, a very narrow ten-year range. (An interesting lookback - one hundred years ago in 1920, 10 Yr Investment Grade (IG) Railroad Bonds yielded 6.35%). During the decade, inflation remained stubbornly below 2% (as measured by PCE). The advent of negative interest rates was an economic event never witnessed before. Central Banks around the world, led by the Bank of Japan (BoJ) and the European Central Bank (ECB), pushed sovereign debt yields into negative territory. This was designed to jump-start slow-to-no-growth economies and boost inflation - it has not worked. The amount of negative yielding debt remains significant at $11 trillion, although, the amount has come down from the record of $14 trillion reached in August of 2019.



Source: FHN Financial

Key Interest Rates	12.31.19	12.31.18	12.31.17
Prime Rate	4.75%	5.50%	4.50%
Fed Funds Rate	1.50% – 1.75%	2.25% – 2.50%	1.25% – 1.50%
3 Month U.S. T-Bill	1.55%	2.45%	1.39%
5 Yr U.S. Treasury Note	1.69%	2.51%	2.21%
10 Yr U.S. Treasury Bond	1.92%	2.68%	2.41%
10 Yr AAA Municipal Bond	1.44%	2.28%	1.99%
10 Yr A Corporate Bond	2.73%	4.11%	3.25%

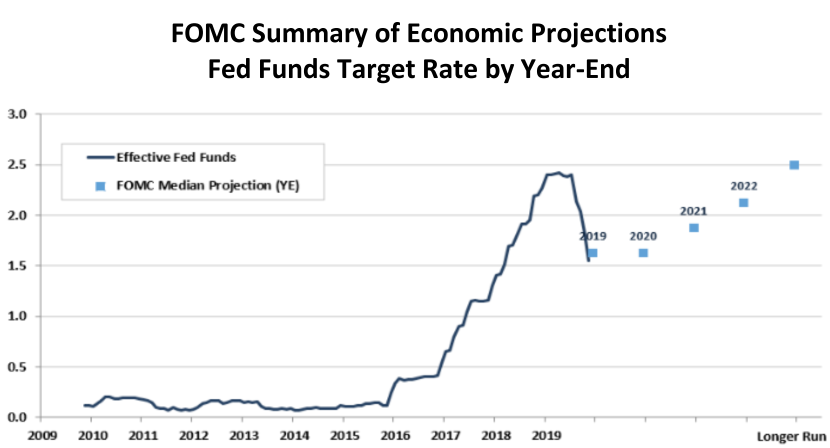
Source: Bloomberg, Wall Street Journal, Reuters, Municipal Market Data (MMD), FactSet

Domestically, the FED started the decade with the Fed Funds Rate (FFR) at 0% and held rates at this level for half of the decade. In December of 2015, the FED started to remove the aggressive accommodation that it put in place to counter the financial / economic stress resulting from the Great Recession. The FED raised short term interest rates nine times over a three-year period to a range of 2.25% - 2.50%. Mid-year through 2019, the FED reduced rates three times to a range of 1.50% - 1.75% to offset an inverted yield curve and the potential economic weakness that could have resulted from the prolonged uncertainty of the trade war with China.

The decade of the 2010s will go down in history as ***the decade of globally coordinated monetary stimulus*** - a coordination with no historical comparison. During 2019 alone, 56 Central Banks cut rates 129 times! As we ended the decade, the BoJ's discount rate, our equivalent to the FFR, stood at -0.10% (yes, negative) and the ECB's rate was -0.50% (yup, another negative). In the U.S., the FFR stood at 1.55%. Additionally, Europe, Japan, and the U.S. all currently have active quantitative easing (QE) programs in place. The U.S. remains the pinnacle of economic strength on a global basis - which creates long term competitive challenges (currency) - but that is a topic for a later conversation.

We are frequently asked if rates could go negative in the U.S. As a country, we are fortunate to be watching Japan and Europe's "negative rate policy experiment" - which is not working. We believe that the inevitable next recession, which we do not foresee in 2020, will be matched with a lower FFR and more QE. However, the primary source of stimulus will have to come from fiscal policy (think massive infrastructure projects) as the FED's ability to stimulate the economy has diminished. Any fiscal stimulus (lower taxes / increased spending) will result in ever increasing levels of Debt / GDP, which in turn, will put further strain on sovereign debt ratings. Our rationale is that reducing interest rates from current levels to zero will have a nominal impact on stimulating economic growth compared to the impact in 2008 when the FFR was rapidly reduced from 5.25% to 0% - that is a shot in the arm! Monetary policy has worked over the last ten years but is exhausted and we do not expect it will work as effectively in the decade ahead. If we are correct with our thesis, the FED will play it safe, for as long as possible, encouraging economic growth and above target inflation. Accordingly, we believe the FED is on hold until we see inflation sustainably above their 2% target. Chicago FED President Evans recently said, "it's important that we overshoot at this point in the economic cycle." FED Chair Powell stated, "it would take a significant move up in inflation that is persistent" for him to support a rate hike. Alternatively, we believe the FED will be quick to further cut rates on signs of weakness. Historically, the FED has been shy in adjusting rates close to a Presidential election - this is illustrated in the FED's dot plot chart. We believe this will remain true as November approaches.

We enter 2020 with a positive economic outlook driven by a strong consumer and solid business confidence. Most economists expect the economy will benefit from a modest GDP boost resulting from the signing of the Phase 1 China trade deal. However, the economy is not without risks as Phase 2 trade tensions remain, the Presidential election looms, global debt levels (consumers, businesses, and governments) continue to rise, and Middle East tensions escalate. While trade negotiations weighed on global growth in 2019, the Phase 1 agreement should put the wind at our backs in 2020. Most economists anticipate U.S. GDP growth around 2.5% for 2020 - slightly better than the prior ten-year average. The ECB sees 2020 economic growth at 1.1% in Europe and the BoJ sees growth at 1.0% in Japan, indicating a continued soft global growth scenario for 2020. The U.S. remains the only game in town for foreign investors seeking positive yielding, high quality, and liquid fixed income assets.



Source: December 2019 FOMC SEP, Bloomberg, Vining Sparks

Carret Credit Insight

Given the challenges ahead in accelerating global economic growth, we believe New York FED President Williams has it right when he recently said, "low inflation, and the corresponding low interest rate environment, are largely a result of global, longer-term structural factors that are unlikely to reverse any time soon." He added, "demographic changes, slow productivity growth, and demand for safe assets" indicate interest rates will "stay lower than we've come to expect in the past". The decade ahead will look materially different than the decade just passed. Our disciplined, opportunistic approach to investing will hold constant.

FED's Economic Outlook: The FED's latest *Summary of Economic Projections* reduced its inflation forecast for 2020 while slightly increasing economic growth expectations and a modestly lower unemployment rate. FOMC members indicated via the dot plot survey that the FFR will stabilize near the current level for the foreseeable future. Thirteen participants now believe the target rate range will be unchanged through at least the end of 2020 with just four expecting one 25 bp increase. The key changes were as follows:

- The dot plot survey indicates the FED is on hold
- Core inflation forecasts (PCE) were dialed back and are now expected to rise by 1.8% - 1.9% this year, compared to the 1.8% - 2.0% expected previously
- 2020 economic growth (GDP) was revised up from 1.8% - 2.1% to 2.0% - 2.2%
- The unemployment rate was lowered from 3.6% - 3.8% to 3.5% - 3.7% - given that the December rate was 3.5%, unemployment is expected to remain stable for 2020

Bottom Line: The prior decade produced the largest globally coordinated monetary policy stimulus ever experienced. The decade ahead will require fiscal policy initiatives to combat any economic slowdowns. This in turn will add debt to an already debt heavy global economy, which in turn, will further stress sovereign balance sheets, reducing the growth investment opportunities in the decades ahead.

Looking at 2020, we see domestic GDP growth north of 2%, inflation remaining tame, record corporate earnings (S&P 500), a low probability of a recession, increased volatility as the November elections loom, and a FED on hold. The yield curve remains nominally upward sloping, indicating short to intermediate duration portfolios offer attractive risk/reward profiles. We are working hard to take advantage of "trading windows" to extend duration. We continue to see opportunities in lower rated corporate credits given the record level of corporate revenue and earnings.

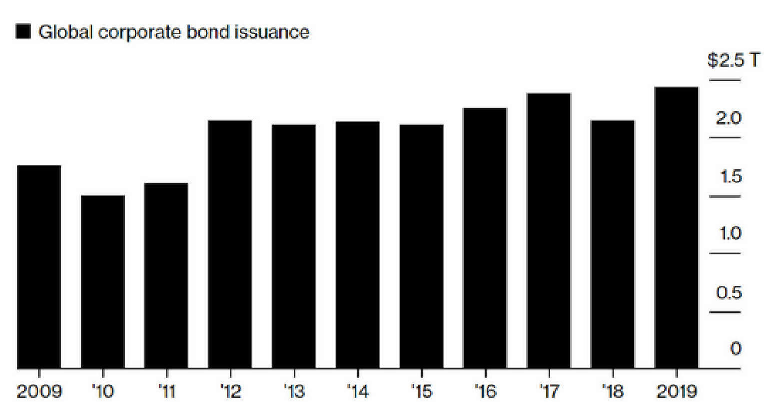
Our 10 Yr U.S. Treasury forecast for 2020 is 2.6% (PCE at 1.6% + a 100 bp return premium). However, as discussed in our mid-year outlook, what are predictions good for? Treasury Inflation Protection spreads are indicating the market expects a 10 Yr U.S. inflation rate of 1.7%. Recall, a 10 Yr Treasury yield below this rate indicates investors are earning a negative inflation adjusted return.

Taxable Bond Strategy

As the economic expansion continues, companies maintain the strategy of issuing new bonds to fund mergers, acquisitions, and stock repurchases in addition to normal operating needs. During 2019, companies took advantage of lower yields and issued a record amount of debt globally. The newly issued debt is also being structured with longer average maturities which has allowed corporate America to pay lower average interest rates on debt that they will not need to repay in the near future. Investors were more than happy to match this supply with solid demand, as evidenced by falling

Corporate Debt Bonanza

Companies in 2019 rushed to sell debt across currencies as rates fell



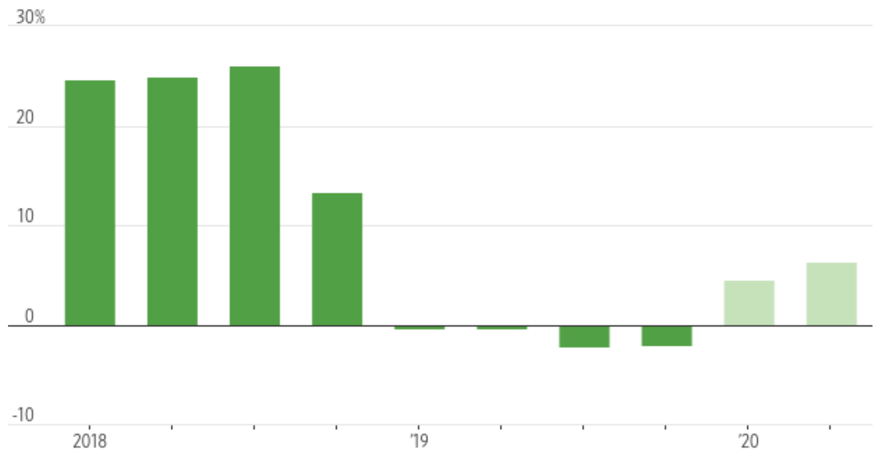
Source: Bloomberg

Note: Data for 2019 are through mid-December, while other periods are for full year yields (rising prices) across the corporate bond market as the year progressed. The U.S. corporate bond market was a particularly attractive sector for investors during 2019. With a large percentage of international sovereign and corporate debt markets trading at negative yields, global investors followed positive yields into the U.S. Bond funds attracted over $400 billion in net investor money while domestic and international equity mutual funds and ETFs saw net fund outflows. According to EPFR Global Data, fixed income funds have experienced inflows for 49 consecutive weeks marking the largest continuous gain since 2001.

A Potential Rebound

Analysts believe earnings growth among U.S. companies will pick up in 2020 following four straight quarters of shrinking profits

Change in S&P 500 earnings from quarters in the previous year



Source: FactSet
Note: Data for the fourth quarter of 2019 is a blend of results and estimates. Data for the following quarters are estimates.

S&P 500 earnings continued their decade of expansion during 2019. While 2019 earnings growth may have been weaker than in years prior, analysts believe that the earnings growth rate will pick up in 2020. The earnings story continues to support the relative value of corporate bonds versus the rest of the global fixed income landscape. The dramatic rise in the S&P 500 has increased market capitalizations and therefore strengthened the debt to equity market value ratios of the U.S. corporate bond market.

As of December 31st, we remain overweight corporate bonds with an emphasis on A and BBB credits. During the second half of 2019, 5 Yr A rated yields fell 24 bp (2.53% to 2.29%) and 5 Yr BBB yields fell 30 bp (3.01% to 2.71%). Relative to 5 Yr U.S. Treasuries, corporate spreads tightened over the past six months with A rated spreads falling from +78 bp to +59 bp and BBB rated spreads moving from +125 bp to +101 bp. We find these levels to be less attractive on a historical basis despite the persistently low yields of U.S. government debt. The 2 to 10 spread ended the 2nd half of 2019 wider than it began; however, we did see an inversion of the yield curve during this period. The year-end spread of +35 bp - while slowly widening quarter over quarter - is still less steep than normal on a historical basis. As such, we continue to target a 3+ Yr duration until we are given an opportunity to extend and earn a meaningful yield pickup.

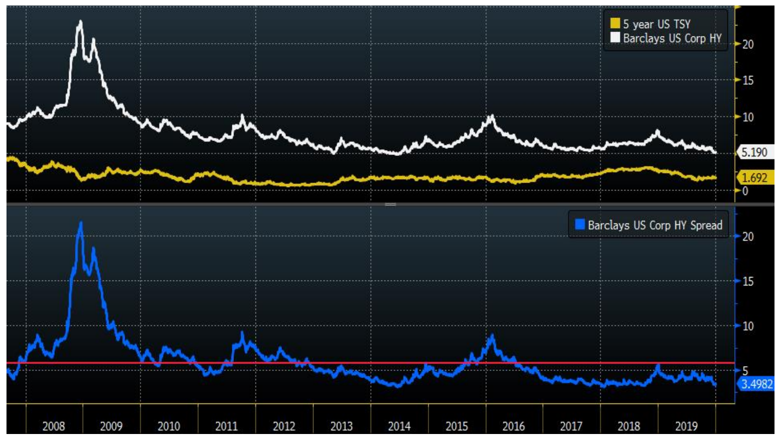
Our ***Taxable Bond Strategy*** is focused on high quality IG, intermediate maturity bonds. Portfolios are structured to generate an average yield to maturity (YTM) of 2.23% with a duration of 2.6, and an average credit rating of A-. We remain overweight corporate bonds relative to our benchmark but are looking to increase our exposure to U.S. Treasuries and Agencies as corporate bond spreads have continued to tighten. We emphasize that we are comfortable taking on risk if we are getting paid to do so. If spreads continue to tighten, we will look to take some credit risk off the table.

Opportunity Strategies

Demand for high yield (HY) debt rocketed higher during the 2nd half of 2019. Investors, seeking yields above the 1.69% offered on 5 Yr U.S. Treasuries and negative yields abroad, found the 5%+ yields offered in the HY market attractive, regardless of the risk profile. Investor's yield grab coincided with S&P 500 volatility (VIX 3 Mos) drifting lower throughout the year. We are aware that HY has a roughly 30% correlation to equities, but equities experienced a one way upward move during 2019. We believe that passive HY ETF investors are in for a rude awakening when equity volatility arrives - which it inevitably will. With yield to maturities at 4.57% (HYG) and 5.80% (JNK) for the two largest HY ETFs, investors are "forgetting" about the 2.5% historical loss rate (bankruptcies). While we believe the loss rates will be lower than historical averages in the years ahead, even a 2.0% loss rate brings yields down to 2.57% and 3.80% respectively. We do not believe these potential returns properly compensate investors for taking on HY volatility. During the 4th Q of 2019, C and D rated (S&P ratings) HY bonds experienced a material sell-off as investors became concerned about a potential economic slowdown. Carret's opportunity strategies invest in high quality HY bonds (versus the ETFS that invest down quality) complemented with a 10% exposure to special situation income opportunities. Given our views above, we find value in short duration HY bonds and are being patient until volatility returns.

Barclays U.S. Corp High Yield Index vs 5 Yr U.S. Treasury

(with spread)



Source: Bloomberg, Barrons

At year end, on average, 29% of our Opportunity Strategy was invested in IG bonds while the Leverage Opportunity Strategy had 53% invested in IG bonds. With over-weighted positions in the IG space, we are positioned extremely well for a return to volatility. HY spreads, the yield differential between U.S. Treasuries and HY bond yields, tightened 137 bp this year while rates on 5 Yr U.S. Treasury bonds declined 76 bp. This combination resulted in meaningful returns for HY investors during 2019. At year-end, HY yields sat at 5.54% as measured by the iBoxx HY Index. Spreads, as measured by the index versus the 5 Yr Treasury, tightened to +385 versus +522bp at the beginning of the year. Spreads continue to remain below the 20 Yr historical average spread of approximately +580bp indicating HY bonds, on a historical basis, are extended. We are defensively positioned and see value in short duration, higher quality HY. If credit spreads widen or interest rates rise, we are very well positioned to capitalize on the downdraft this would bring to the index. We continue to take advantage of high coupon callable issues with the goal of benefitting returns while reducing volatility; however, this strategy has increased the turnover in portfolios.

At year end, our ***Opportunity Strategy***, on average, had a YTM of 3.41%, a duration of 2.8, and an average credit rating of BB. Our ***Leveraged Opportunity Strategy***, on average, had a YTM of 3.61%, a duration of 1.9, and an average credit rating of BB+. We remain unlevered as yields remain uncompetitive to the cost of borrowing.

Enhanced Cash Strategy

During the 2nd half of 2019, the bond market narrative was focused on the inverted yield curve (rates on 2 Yr Treasuries higher than those of their 10 Yr brethren) which occurred in late August, and the perceived probability of a near-term recession that a yield curve inversion has historically predicted. And for much of this period, rates on the ultra-short end of the curve (1 Yr and shorter) were higher than those out longer, thus offering more attractive spreads less than 6 months, than even out one year.

U.S. Treasury 3 Month Bill Money Market Yield

Source: Bloomberg

As we've discussed above, the FED lowered the FFR three times during this period, so that by late autumn, ultra-short rates had come down significantly from where they were in mid-summer: from July 1st to December 31st, yields on 3-month Treasuries dropped from 2.15% to 1.53% - almost a 30% decline. When ultra-short rates "normalized" late in the year (a positive-sloping yield curve from 1-month to 12-

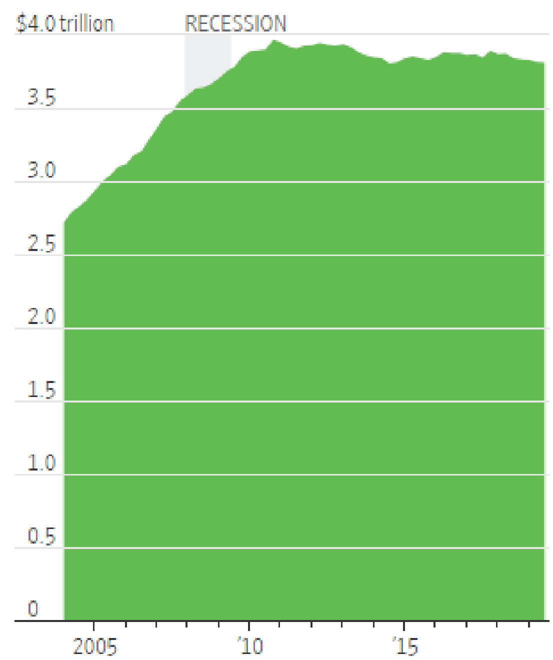
months), we took the opportunity to pick up yield and extend duration with maturing bond proceeds.

Going forward, with both the bond market and the FED indicating no expected cuts (nor hikes) in the FFR for 2020 - and a continued positive-sloping yield curve - we expect to keep extending portfolio duration and locking in as much yield as the IG bond markets will provide. We believe the style of active bond management that our Enhanced Cash strategy utilizes - producing attractive yields without giving up quality nor liquidity - is superior to the average rates offered by money market funds and bank CDs.

The ***Enhanced Cash Strategy*** invests in a tactful mix of liquid, ultra-short duration Corporate, U.S. Agency, and U.S. Treasury bonds, periodically adding tax-advantaged Municipal bonds to enhance overall returns when appropriate. At year end, our portfolios averaged a 1.90% YTM, an average credit rating of A, and a 3-month duration.

Municipal Bond Strategy

Total Municipal Debt Outstanding



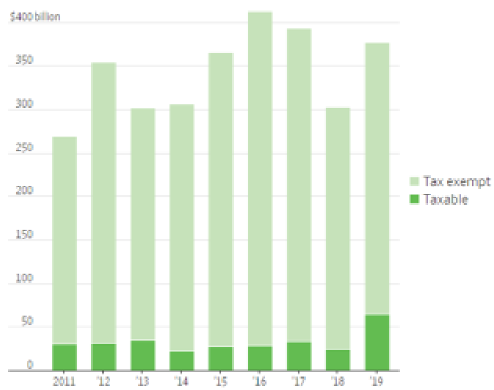
Source: Refintiv

Municipal bond investors continue to bask in the light of favorable market conditions. Positive supply and demand dynamics, sound fundamentals, and limited headline risk continue to boost bond prices. As yields trend lower around the globe, municipal bonds continue to offer compelling taxable equivalent yields. The constructive market dynamics that are currently in place show no sign of significant change in the near-term. Investors in search of tax-free income, total return, and diversification appear eager to move more dollars into the municipal bond market in 2020. An interesting observation is that the size of the municipal market has remained relatively steady over the past several years, despite strong buy-side demand. The size of the market peaked in the 4th Q of 2010 at $3.97 trillion and ended 2019 at $3.64 trillion. For perspective, according to Bloomberg Intelligence, the corporate bond market has increased almost 30% over the past decade with outstanding debt approaching $10 trillion.

During the second half of 2019, market yields (5 Yr AAA) continued to grind lower. Keep in mind that falling yields generally correspond with rising prices. The 2019 low yield was recorded on August 15th at a 0.95% level. The year began with 5 Yr AAA yields at 1.94% and closed the year at 1.14%. As the macroeconomic backdrop steadied in late-fall, market yields broke trend as yields rose roughly 40 bp from mid-August until mid-September. At times, the slope/shape of the yield curve (2 Yr bonds versus 10 Yr bonds) can influence our duration decisions more than yields. As bond yields fell in the last quarter of 2019, the slope of the yield curve steepened. This relationship provides a framework for moderate maturity extension as incremental yield can be achieved through gradual duration extension. In the big picture, however, yields have been hovering near historic lows with a relatively flat yield curve. These factors certainly limit how much interest rate risk we are comfortable taking at this point in time.

Municipal market dynamics continue to demonstrate the overwhelming demand for municipal bonds. According to Refinitiv Lipper, all 52 weeks of 2019 experienced net positive inflows into municipal bond mutual funds. Combine that with strong buy-side activity from separately managed accounts and institutional buying, and you have quite the surge of investor demand. Separate from new dollar-demand, proceeds from matured and called bonds were significant during the second half of 2019, totaling $137 billion. Although much of the focus appears to be on high tax states, municipal investors nationwide continue to find value in the municipal bond sector. The high credit quality of municipal bonds, combined with attractive relative yields, provide the key fundamentals for strong demand.

Municipal Bond Total Issuance



Source: Refintiv

On the supply side, new issuance totaled $365 billion in 2019 with nearly 40% coming to market in the last quarter of the year. Interestingly, issuance in the first week in December was only $1 billion shy of the weekly record of $29 billion reached in December of 2017 when issuers rushed to borrow ahead of the Tax Reform Act of 2017. Total supply for 2019 was up roughly 20% over 2018 levels. A new wrinkle taking shape from the supply side is the increased amount of taxable municipal bonds coming to market. In fact, the volume of taxable bond new issue supply nearly doubled from 2018 to 2019. However, net tax-free supply increased a more modest 12.5% year-over-year, with net tax-free new issuance sitting at $315 billion for 2019. That calculus goes a long way in explaining the imbalance of demand over supply.

This begs the question: why did the new issue supply of taxable municipal bonds grow in 2019? Following the Tax Reform Act of 2017, which ended the use of tax-free bonds to advance refund outstanding (higher cost) debt, issuers opted to structure refinancing transactions using taxable municipal bonds to avoid the restrictions of the 2017 tax bill. Investors may recall the 21-month run of Build America Bonds (BAB) in 2009 and 2010. The BAB program was created as part of the American Recovery and Reinvestment Act of 2009 and generated roughly $180 billion of new taxable debt. During the BAB era, municipalities received a government tax benefit to offset costs and put issuance yield at parity versus tax exempt issues (for the issuer). In this post-BAB era, taxable municipal bond issuers do not receive a government subsidy to offset costs and create parity. Currently, taxable municipal bond issuers can refinance higher-cost debt and broaden the universe of potential investors. We still have concerns regarding relative value and liquidity for taxable municipal bonds. However, we will continue to watch this emerging segment closely.

The Municipal-to-Treasury Ratios (MOT) continue to be an important tool for us to help measure the relative value of tax-free municipal bonds versus comparable Treasury bonds. The second half of 2019 produced notable swings in these ratios as economic and fundamental crosscurrents drove yields across the fixed income markets. The 10 Yr MOT ratio peaked at 90% in late-September following a 30-day uptick in bond yields. The 90% ratio was short lived, however, as municipal bond yields declined more than Treasury yields in the last 3 months of the year. The 10 Yr bond ratio closed the year at 77% indicating "fair value" of municipal bonds compared with Treasury Bonds.

From the credit perspective, conditions have generally improved, with limited headline risk. Climate change and its potential impact for municipal bonds captured the attention of the investment community in 2019. A report from the PEW Institute, entitled "Climate Change Could Make Borrowing Costlier for States and Cities," is a reminder that climate considerations can have a meaningful impact on the credit profile of individual issuers, today and in the future. Moody's has begun to incorporate climate factors into its rating analysis and narrative. Moreover, Moody's recently acquired a controlling stake in Four Twenty Seven, a firm that provides market intelligence on the economic risk of climate change for over 750 US cities and 3,000 counties. We have woven this emerging concern into our micro and macro credit analysis process.

Our high quality, intermediate-duration focus continues to seek a balance of preservation of principal, total return, and tax-exempt cash flows. We will continue to opportunistically add value through credit research, bond structure, and yield curve positioning. Our municipal bond portfolios are actively managed as either state-specific or state-focused (general market in approach otherwise). Essential service revenue bonds and high-quality general obligation bonds continue to make up the framework of our municipal bond portfolio strategy. We continue to be constructively optimistic in our expectations for the municipal marketplace in 2020. Our ***Municipal Bond Strategy*** is focused on high quality investment-grade, intermediate-maturity bonds. Portfolios are structured to generate an average YTM of 1.67% and a Taxable Equivalent Yield (TEY) of 3.19%* with a duration to maturity of 4.5 years, and an average credit rating of AA-

** Assumes 48.3% Combined Effective Tax Bracket*

Separately Managed Account Strategies:

Municipal: Carret's Municipal Bond Strategy is designed to maximize tax efficiency through opportunistic portfolio management while preserving principal through practical portfolio structuring and fundamental credit analysis. We actively manage investment grade portfolios with a diversified blend of issuers, sectors, and maturities aimed at delivering consistent, risk-adjusted returns with an emphasis on tax-efficient cash flows.

Taxable: Carret's Taxable Bond Strategy is designed to achieve above average total returns with an emphasis on preservation of capital and consistent cash flow. We utilize investment-grade fixed income securities and shift across bond sectors based on changing market conditions. Our fundamental credit research and active portfolio management process has provided consistent and attractive risk-adjusted returns.

Opportunity: Carret's Fixed Income Opportunity Strategy is designed to generate a high level of current income with a secondary focus on long term capital appreciation. We utilize higher yielding fixed income securities and shift among various types of fixed income securities based on changing market conditions. We actively manage risk and reward and can respond quickly to market movements. We utilize interest rate hedges to limit duration risk.

Leveraged Opportunity: Carret's Fixed Income Leveraged Opportunity Strategy is designed to utilize low cost leverage and favorably negotiated release rates to potentially enhance our existing Opportunity Strategy returns. We actively manage leverage to augment opportunities within the high yield and investment-grade sectors of the fixed income market.

Enhanced Cash: Carret's Enhanced Cash Strategy seeks to provide excess returns above those offered by cash equivalents, while focusing on capital preservation and liquidity. The strategy invests in ultra-short duration investment grade bonds. Our custom approach opportunistically utilizes tax-advantaged municipal bonds to enhance overall after-tax returns when appropriate.

Mutual Fund Strategy:

Kansas Tax-Exempt: The Carret Kansas Tax-Exempt Bond Fund's objective is to preserve capital while producing current income that is exempt from both Federal and Kansas state taxes. The Fund seeks to generate monthly income and principally invests in investment-grade bonds of intermediate maturity.

For more complete information on the Carret Kansas Tax Exempt Bond Fund, you can obtain a prospectus containing complete information for the Funds by calling 888.266.8787 or by downloading it from Carret's web site. You should consider the Fund's investment objectives, risks, charges and expenses carefully before you invest or send money. Information about these and other important subjects is in the Funds' prospectus. The prospectus and, if available, the summary prospectus, should be read carefully before investing. Shares of the Carret Kansas Tax Exempt Bond Fund are distributed by ALPS Distributors, Inc., which is not affiliated with Carret Asset Management, LLC.

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