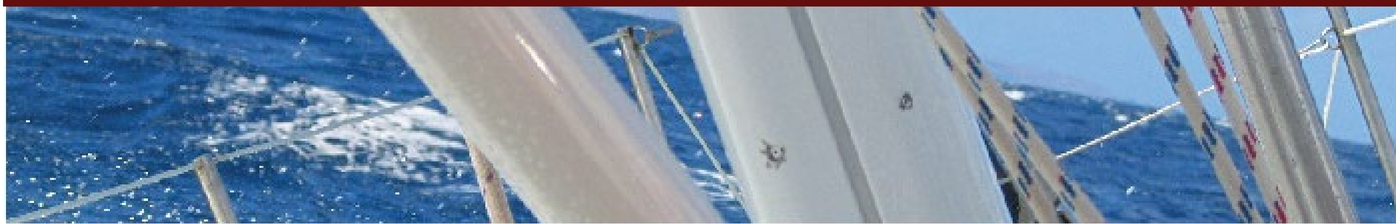
CARRET
Asset Management

January 2025

Carret Credit Insights



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Firm AUM (12/31/24)

$3.237 Billion

The FED's Inflation Fight Gets More Complicated

The Federal Reserve (FED) lowered interest rates by 50 basis points (bp) on September 18th, its first rate cut in four and a half years. On that date, the yield on the 10Yr U.S. Treasury (UST) stood at 3.62%. The FED cut again on November 7th and December 18th by an additional 25 bp on each date, bringing the decrease in the Federal Funds Rate (FFR) to 1.00% from September of 2024 to December of 2024. Interestingly, the yield on the 10Yr UST stood at 4.58% at year-end… So, the FED cut rates by a full 1.00% and long-term interest rates increased by 0.96%.

Why did long rates increase while the FED was lowering rates? It's important to remember that the FED controls the FFR, which is the interest rate that banks charge each other to borrow money overnight. Meaning, the FED controls short rates via the FFR. While the FED can "influence" longer-term interest rates utilizing quantitative easing and tightening, it begs the question of who sets longer-term interest rates? INVESTORS! Investors see a robust economy, coupled with stubborn inflation, and an uncertain geopolitical future. In lowering the FFR, the FED added monetary stimulus to a still complex inflation picture, causing investors to send rates higher.

While inflation has subsided from the uncomfortable levels of 9.0%+, it has stalled above the FED's 2.0% target, remaining frustratingly in the 2.8% - 3.3% range, led by a resilient economy and strong consumer. Heading into the election, the FED was concerned that restrictive monetary policy could stall economic growth and increase unemployment. With a focus tilted more towards the maximum employment mandate, the FED eased. Since the elections, we believe the focus has returned more towards the stable price (2% inflation) mandate.

Key Market Levels	12.31.24	12.31.23	12.31.22
Fed Funds Rate	4.25% – 4.50%	5.25% – 5.50%	4.25% – 4.50%
3 Month U.S. T-Bill	4.32%	5.35%	4.41%
10 Yr U.S. Treasury Bond	4.57%	3.88%	3.88%
5 Yr AAA Municipal Bond	2.87%	2.28%	2.52%
5 Yr A Corporate Bond	5.11%	4.41%	5.22%

Source: Municipal Market Data (MMD) and FactSet

We believe inflation will continue to decline in 2025, albeit at a very slow rate. However, the FED will face a protracted battle with inflation given the macroeconomic/geopolitical uncertainties that will surface from Washington. We are monitoring the following inflationary forces: higher tariffs, immigration/deportation, lower taxes, looser regulation, onshoring, and the increasingly in focus U.S. deficit/debt. One wild card is fiscal stimulus (government spending). Many in Washington want spending to be curtailed, while others want to spend, build, and grow our way out of our debt problems (as a % of GDP). Despite the creation of the Department of Government Efficiency (DOGE), we are in the camp that sees spending increasing, not decreasing - another inflationary item.

The last thing the FED wants to do is backtrack and be forced to increase the FFR if inflation rises; accordingly, we believe they will leave the FFR at its current modestly restrictive level until many of the aforementioned items become clearer. In the interim, the U.S. Government continues to accrue debt at a rapid pace ($710 Billion in the 4th Q of 2024 - a 40% Y/Y increase). The U.S. Treasury will face significant challenges in 2025, with nearly $3 Trillion in U.S. debt maturing in addition to an estimated $2 Trillion deficit. With $5 Trillion in UST financing in 2025, we anticipate Treasury auctions will struggle and longer-term interest rates will remain elevated.

Looking forward, uncertainty creates opportunities – we anticipate many opportunities in 2025, which will benefit fixed-income investors!

U.S. Treasury Bond Market Update

2024 saw the yield on the 6 Month UST decrease 99 bp from 5.26% to 4.27%. Ultra-short rates decreased as a result of three FED rate cuts totaling 100 bp. We anticipate the FED will ease slowly in 2025, keeping short rates attractive.

During the year, the yield on the 5 Yr UST increased 53 bp from 3.85% to 4.38%. Intermediate rates increased during the year as inflation remained stubbornly above the FED's 2.0% target. While investors anticipate a solid economy in 2025, doubts remain about the FED's ability to curtail inflation to the 2% target.

Taxable Bond Market Update

During 2024, the U.S. corporate bond market saw interest rates climb alongside UST yields despite corporate spread tightening. Investment Grade (IG) spreads are now at their lowest level since 2005. Corporate spread tightening can be contributed to two factors: the strength of U.S. corporations and increasing worry about the growing debt load of the U.S. government. Investor confidence in U.S. corporations is supported by near record low net interest payments, near record S&P 500 earnings, and a strong consumer base. Concerns related to the U.S. government include the debt-to-GDP ratio crossing 1.0, growing government spending and obligations, and ballooning interest payments on the debt. IG issuance remained strong in 2024 (up 27% over 2023) as companies took advantage of the low spread environment to refinance existing debt and fund capital projects.

High Yield (HY) spreads, as measured by BB rated credits, are the tightest they have been in twenty years, indicating investors may be growing complacent; however, we remain vigilant. In 2024, U.S. bankruptcies reached their highest level since 2010 despite net rating upgrades across the market. This dichotomy leads us to emphasize credit research while demanding higher rates for a given level of risk. We believe HY investors should remain short duration focused and defensive in nature.

Looking forward, there are both opportunities and risks to the corporate bond market. Attractive market yields provide income return for investors while cushioning the blow of potentially higher rates. Diversification is easily achievable while not sacrificing return as the breadth of desirable yields is apparent. Spread widening can hurt investors if it is material. Market wide and industry wide risks to spreads include tariff headwinds, inflation reacceleration, or an economic recession. We anticipate that a solid corporate environment and a slow-moving FED will hold yields at attractive levels providing strong cash flows and total returns for investors in 2025.

Municipal Bond Market Update

We believe that the outlook for municipal bonds in 2025 is favorable. Municipal yields ended the year near 20-year highs. Municipal bonds continue to be a compelling asset class that offers investors attractive absolute and taxable-equivalent yields along with sound credit fundamentals.

Elevated municipal supply reached record levels in 2024 as pent-up issuer activity and the acceptance of a higher-for-longer rate environment drove the primary market. Tax-exempt municipal bond supply rebounded in 2024, after tepid issuance in 2022 and 2023. New issuance, for the year, was $508 billion which was $123 billion greater than 2023. Overall new issuance for 2024 was the largest amount since 2014 and ran 23% higher than the 10 Yr average issuance. Supply volume in 2025 will be influenced by federal tax policy. With the new administration in D.C., we anticipate that the TCJA will be extended in some form, which is likely a net neutral for municipal investors. Outside of

tax policy, we anticipate potent tax-exempt supply due to ongoing infrastructure needs and matured proceeds volume. We expect another year of strong issuance that could again approach $500 billion.

Demand for municipals remains strong. From the flow of funds perspective, 2024 net inflows totaled $29 billion. Cash equivalent yields have shrunk with the inversion unwinding. As we bid farewell to the front-end yield curve inversion, we remind our readers that this is the only time that a protracted inverted municipal curve has occurred. A reduced FFR combined with a robust economy produced a steeper yield curve. The steepness makes a compelling argument to lengthen maturities to capture higher yields.

As we evaluate relative value for municipal bonds, we have modified one of our tools to reflect today's landscape. The historical average for the 5 Yr Muni-to-Treasury ratio is 85%. However, the market experienced a structural shift over the last five years. U.S. households, the primary buyer of municipal bonds, have doubled their "bond buying power" while the municipal market has seen nominal growth in the overall size of the market. The structural supply/demand imbalance has moved the ratios lower, making sub-70% ratios the new normal.

Municipal credit strength endures. Issuers should be well-positioned after the past few years of solid fundamentals. Throughout the year, rating upgrades outpaced downgrades by a 2.5 to 1 margin. Looking forward, robust revenues and record funding of reserves for state and local governments make municipal credits well-positioned to manage effectively through economic strength or uncertainty. Credit research is key to portfolio performance, helping to identify opportunities for relative value and credit upside.

We do not expect essential service providers, especially those funded with local tax revenues, to be materially affected by policy changes at the federal level. With elevated municipal yields, strong fundamentals, and attractive spreads, we anticipate a solid year ahead for the municipal marketplace.

Data as of December 31, 2024	Taxable Fixed Income	Municipal Fixed Income	Opportunity Fixed Income	Enhanced Cash
Maturity	4.7	7.1	3.0	0.20
Duration / Dur to Worst	4.1	5.8 / 3.8	2.7	0.20
YTM / YTW	4.98%	3.66% / 3.28%	5.84%	4.56% [3]
Taxable Equiv YTM/YTW		7.08% / 6.34% [1]		4.81% [1,2,3]
Coupon	3.95%	4.48%	5.37%	1.35%
Credit Rating	A-	AA	BB+	AA

Source: Carret / Bloomberg

Sector Allocations:				
U.S. Treasury	12%	1%	1%	60%
Government Agency	9%			4%
Corporate - Inv Grade	72%	1%	36%	31%
Corporate - High Yield			54%	
Preferreds	5%		7%	
Convertible				
Municipal		97%		1%
Cash	2%	1%	2%	4%

[1] Assumes a combined federal and state effective tax rate of 48.30% [2] Assumes a state tax rate of 7.50% [3] Yield on Invested Assets

Taxable Fixed Income Strategy:

- The Taxable Fixed Income Strategy outperformed the Bloomberg Intermediate Gov't Credit Index during the year with a gross return of 4.2% and net return of 3.8% versus the index's return of 3.0%.
- The strategy's overweight exposure to corporate bonds contributed to outperformance relative to the index. Corporate bonds contributed positively on a cash flow basis due to higher coupon cash flows relative to the

index. The overweight position positively impacted performance on a price basis versus the index as corporate bond spreads finished the year tighter than where they began 2024. Additionally, beginning the year with a shorter relative duration and opportunistically timing duration extensions as yields moved higher contributed to outperformance versus the benchmark.

- IG spreads, as measured by the 3-5 Yr A rated FactSet Index, tightened by 43 bp during the year, decreasing from 110 bp to 67 bp.
- IG spreads, as measured by the 3-5 Yr BBB rated FactSet Index, tightened by 42 bp during the year, decreasing from 134 bp to 92 bp.
- Strategy duration, at 4.1 Yrs, has been extended from 3.5 over the past year in light of attractive longer-term yields and as the UST curve is no longer inverted. We continue to look for opportunities to position the strategy duration along a positive sloping yield curve.
- Average portfolio quality remained steady Y / Y at A-.
- The strategy's Yield to Maturity (YTM) increased during the year from 4.89% on December 31st, 2023 to 4.98% at year end.
- The strategy's top three economic sectors are Financials, Energy, and Information Technology.
- The strategy's 5% allocation to preferred securities provides higher yields and aims to capture incremental cash flows.
- We continue to find value in corporate credits and remain overweight vs the index with an allocation of 72% to corporate bonds. Additionally, U.S. Agency bond valuations are attractive, boasting healthy spreads above UST. During the year, exposure to U.S. Agencies increased from 8% to a 9% allocation.
- Looking forward, the strategy aims to capitalize on swap opportunities as well as the reinvestment of maturities, calls, and coupon cash flows into an attractive yield environment. With credit spreads at their tightest level in 20 years, we have an outsize focus on credit research and "knowing what you own".

Municipal Fixed Income Strategy:

- The Municipal Fixed Income Strategy gross return for the year was 1.1% and the net return was 0.8% while the Bloomberg 5 Yr Municipal Index returned 1.2%. Given our state-specific and state-focused investment philosophy, our composite state weighting is influenced by client residency and tax considerations.
- The Municipal Fixed Income Strategy was certainly impacted by the volatility in municipal bond yields. The overall rise in yields was offset by positive coupon driven cash flows. Economic data, municipal supply, and the Presidential election [and subsequent tax considerations] all played key roles in the path of 2024 municipal interest rates.
- Representative AAA rated 5 Yr Municipal Bond yields rose by 67 bp during 2024. The index's YTM began the year at 2.23% and closed the year at 2.90%. Over the same period, 5 Yr UST yields rose by 53 bp.
- The 2 Yr-to-10 Yr municipal curve spread turned positive in August (no longer inverted). The level of inversion began the year at -24 bp and ended the year at +31 bp. The greatest point of inversion for the year occurred in April at -50 bp.
- The Strategy's duration-to-worst is 3.8 and the duration-to-maturity is 5.8 at year-end. The Bloomberg 5 Yr Municipal Index duration-to-worst is 3.7 and the duration-to-maturity is 4.4 at year-end. We have taken a maturity extension stance and have opportunistically lengthened duration-to-maturity from 5.1 to 5.8 over the past 12 months. Higher overall yields combined with the lack of inversion-driven opportunities [in shorter-term maturities] should enable us to continue to extend duration in 2025.
- Average portfolio quality remains AA. The strategy continues to be anchored in high-quality Essential Revenue and General Obligation (GO) credits.
- The strategy's Yield to Maturity (YTM) increased during the year from 3.26% on December 31st, 2023 to 3.66% at year end. The strategy's Yield to Worst (YTW) increased during the year from 2.74% on December 31st, 2023 to 3.28% at year end.
- From the Taxable Equivalent Yield (TEY) perspective, municipals continue to offer compelling relative yields. For example - a 3.28% Tax-Exempt municipal yield equates to a TEY of 6.34% for investors in the 48.3%

combined tax bracket. The Crossover Rate (the tax rate where an investor would be indifferent to owning a municipal or a corporate bond was 41.7% at year-end.

- Looking forward, the strategy aims to opportunistically increase yield by lengthening portfolio maturity. At the same time, we will continue to diligently evaluate credits and market fundamentals against the backdrop of the evolving municipal landscape with the goal of adding value while minimizing risks.

Opportunity Fixed Income Strategy:

- The Opportunity Fixed Income Strategy outperformed the Bloomberg Intermediate Gov't Credit Index during the year, with a gross return of 6.1% and a net return of 5.5% versus the index's return of 3.0%. Our outperformance during the year was a result of our shorter duration structure in a rising interest rate environment, tightening corporate credit spreads, and active credit management.
- HY rates (as measured by the iBoxx HY Index) decreased from 7.58% on December 31st, 2023 to 7.52% at year-end, a nominal decrease of 6 bp.
- HY spreads tightened during the year, decreasing from 373 bp on December 31st, 2023 to 314 bp at year-end, a tightening move of 59 bp, but recall that 5 Yr UST yields increased 53 bp.
- IG spreads, as measured by the 3-5 Yr BBB rated FactSet Index, tightened by 42 bp during the year, decreasing from 134 bp to 92 bp.
- The strategy's YTM decreased from 6.58% on December 31st, 2023 to 5.85% at year end.
- The strategy's top economic sectors are Consumer Discretionary, Financials, Energy, and Industrial.
- The strategy's duration increased during the year from 2.7 to 2.9 at year-end as we took advantage of a steepening yield curve.
- Average portfolio quality held constant Y / Y at BB+; additionally, IG exposure at year-end was 39%.
- With credit spreads at 20 Yr tight levels, we continue to be "defensive". We are focused on high quality HY companies. We believe uncertainty in 2025 will create opportunities. We have ample flexibility to add value as credit and interest rate opportunities arise – nearly 34% of the strategy holdings mature in the next 12 months and almost 80% of the strategy holdings mature in the coming 36 months.

Enhanced Cash Strategy:

- The Enhanced Cash Strategy performed well during the year, with a gross return of 5.3% and net return of 4.9%, outperforming the ICE BofA 0-1 Yr UST Index return of 5.2%.
- Ultra-short-term interest rates declined during the year as the FED lowered the FFR in three consecutive meetings, resulting in 100 bp of rate cuts between September and December.
- The yield on the 6 Month UST decreased 99 bp during the year, falling from 5.26% on December 31st, 2023 to 4.27% at Yr end. The 1 Yr UST finished the year yielding 4.15%, 63 bp lower than where it began the year.
- IG spreads, as measured by the yield of the ICE BofA 0-1 Yr A-AAA U.S. Corp Index relative to the ICE BofA 0-1 Yr UST Index, decreased nominally during the year, declining from 52 bp to 49 bp.
- Average portfolio quality declined slightly during the year as a result of an increased allocation to IG corporate bonds, decreasing from AA- to A+.
- Average portfolio duration increased modestly Y / Y, moving from 0.19 to 0.20 Yrs.
- The strategy's YTM decreased during the year, moving from 6.19% to 4.60%, reflective of the rate cutting policy implemented by the FED.
- While ultra-short rates no longer represent the highest yields across the curve, Enhanced Cash still provides returns above those offered by money market funds, providing a competitive option for investors seeking cash management solutions.
- In 2025, we expect that persistent inflation, a solid economy, and a strong labor market will result in the FED moving slowly on further easing. A slow FED means that ultra-short rates will remain elevated in the near-term, providing attractive opportunities for Enhanced Cash investors.

Carret Credit Insights

Separately Managed Account Strategies:

Taxable: Carret's Taxable Bond Strategy seeks 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 intermediate duration approach (3 - 7 Yrs) seeks to identify the sweet spot on the yield curve and structure maturities accordingly. Active management of the strategy includes forecasting the long-term direction of interest rates and credit spreads. Our fundamental credit research and active portfolio management process has provided consistent and attractive risk adjusted returns.

Municipal: Carret's Municipal Bond Strategy seeks 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. Carret uses a value approach when buying and selling bonds. This method recognizes the inefficiencies of the municipal marketplace and enables clients to benefit from our expertise and market knowledge.

Our high-quality, intermediate-maturity bias is designed to balance preservation of principal, total return, and tax-exempt cash flows. We opportunistically add value through credit research, bond structuring, 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 make up the framework of our municipal bond portfolio strategy. The strategy's primary focus is on high-quality, investment-grade municipal bonds with an intermediate duration of approach (3 - 7 Yrs), which enables us to utilize bonds in the 2 - 12 Yr maturity range.

Opportunity: Carret's Fixed-Income Opportunity Strategies seeks to generate a higher level of current income with a secondary focus on long term capital appreciation. We utilize various types of higher yielding fixed income securities and shift among types based on changing market conditions. We actively manage risk, respond quickly to market movements, and utilize interest rate hedges to limit duration risk. We focus on high quality high yield and low-quality investment grade bonds, and couple them with preferreds and broken convertibles to try to generate above average levels of cash flow.

Our intermediate duration approach (2 - 10 Yrs) seeks to identify the sweet spot on the yield curve and structure maturities, accordingly. Active management of the strategy includes forecasting the long-term direction of interest rates and credit spreads. Our fundamental credit research and active portfolio management process has provided consistent and attractive risk adjusted returns.

Leveraged Opportunity: Carret's Fixed Income Leveraged Opportunity Strategy seeks 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 – those with a maximum maturity of 12 months, and a typical duration of less than 6 months.

Our custom, tailored approach opportunistically utilizes a thoughtful mix of Investment Grade Corporate debt, U.S. Treasury and Agency securities, as well as taxable and tax-exempt Municipal bonds to enhance overall after-tax returns.

Mutual Fund Strategy:

Kansas Tax-Exempt: The Carret Kansas Tax-Exempt Bond Fund seeks 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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