



## Carret Credit Insights



### Full Faith & Credit?

#### Co-Directors Fixed Income

**Jason R. Graybill, CFA**  
212.207.2339  
jgraybill@carret.com

**Neil D. Klein**  
212.207.2340  
nklein@carret.com

#### Firm AUM (6/30/25)

**\$3.370 Billion**

The NOT SO BIG news of the first half of 2025 was Moody's downgrade of the U.S. Government credit rating. Recall, Standard and Poor's (S&P) removed its top rating (AAA) for U.S. Treasuries (UST) back in 2011 and Fitch downgraded its rating in 2023. The Moody's downgrade is simply another recognition that U.S. government debt and interest payment ratios have increased to levels that are meaningfully higher than similarly rated sovereigns. Despite the negative media attention on the downgrade, UST yields decreased (prices increased) in the first half of the year as investors continued to view the U.S. as a safe haven.

Our recent institutional conversations, however, have centered on the perceived safe haven status and the potential for the U.S. to "go broke" – a societal conversation about a day of reckoning that has been ongoing for decades. While we are not concerned about the U.S. Government's ability to service its debt obligations in the near term, we are concerned that the lack of fiscal discipline in Washington will have a long-term negative impact on the U.S. relative to global peers and enemies.

UST bonds are essentially IOUs from the federal government. If the government spends more than it collects in taxes, it must sell bonds to bridge the gap, thus increasing the deficit and total cumulative debt. The math is getting daunting... the total U.S. debt at mid-year was \$36.2 Trillion, according to the U.S. Congress Joint Economic Committee, the interest cost of servicing this debt now exceeds \$1 Trillion per year, and annual deficits are adding to the debt load at a rate of \$1.5+ Trillion per year. We believe that D.O.G.E. will have a nominal impact on cost cuts while the recently passed budget will increase the deficit in the coming years. Therefore, the trend of increasing Federal Debt as a share of GDP that started 25 years ago will continue deteriorating the U.S. Government credit profile in the decades ahead.

What does this all mean? Simply put – the U.S. government will have a diminishing ability to "bail-out" the U.S. economy when the next major downturn hits – think the Great Financial Crisis of 2008-2009 or Covid. Additionally, with more dollars servicing debt instead of being invested in growth initiatives (education, health care, technology, etc.), U.S. and global economic growth will be dampened. From an interest rate perspective, the U.S. government will continue to auction (sell) more debt. If investor demand isn't there, the government has to increase the rate it pays on the debt until it attracts demand – thus pushing interest rates higher and perpetuating the fiscal challenge.

| Key Market Levels        | 6.30.25       | 12.31.24      | 12.31.23      |
|--------------------------|---------------|---------------|---------------|
| Fed Funds Rate           | 4.25% – 4.50% | 4.25% – 4.50% | 5.25% – 5.50% |
| 3 Month U.S. T-Bill      | 4.29%         | 4.32%         | 5.35%         |
| 10 Yr U.S. Treasury Bond | 4.23%         | 4.57%         | 3.88%         |
| 5 Yr AAA Municipal Bond  | 2.68%         | 2.87%         | 2.28%         |
| 5 Yr A Corporate Bond    | 4.64%         | 5.12%         | 4.89%         |

Source: Municipal Market Data (MMD) and FactSet

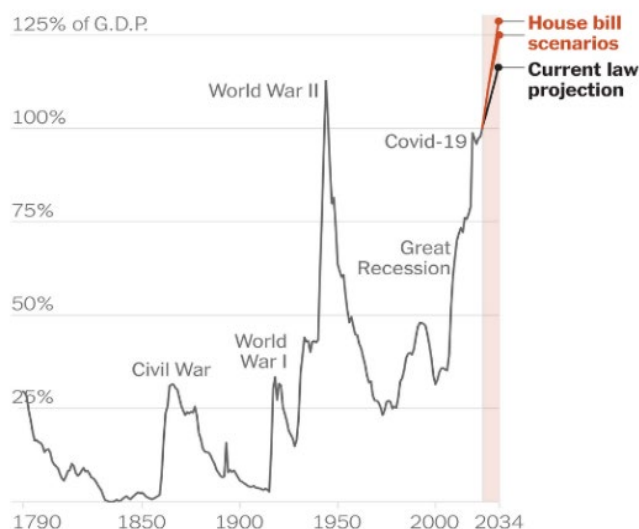
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Interestingly – the BIG news of the year – tariffs were quickly put on the back burner in our conversations. We are not sure if this was because of TACO (Trump Always Chickens Out) or a result of the complexity / annoyance of analyzing weekly, daily, hourly changes to tariff announcements. There is a growing consensus (which we agree with), that tariffs will nominally slow U.S. economic growth and nudge inflation higher.

This consensus is shared by the FED, in our opinion, and is complicating their decision making. The FED is currently in a holding period (against Trump's wishes) as they actively monitor their dual mandate: maximum employment and price stability. With the unemployment rate steady and comfortably below 4.5% and inflation still meaningfully above their 2% target, we believe they are leaning towards fighting inflation. Currently, two Fed Funds Rate cuts are priced into the 2<sup>nd</sup> half of the year. We know the FED's ultimate decision will be data dependent as they wait for further clarity on what worsens first – tariff driven inflation or a weakening labor market. We conclude that inflation will remain elevated into 2026, which will keep market interest rates at current to slightly higher levels.

We recognize that these are complicated and challenging times; however, we would encourage fixed income investors to view the above comments positively as it relates to their bond investment portfolios. Higher rates yield higher long-term returns!

**U.S. federal debt as a share of G.D.P.**



Source: New York Times

### U.S. Treasury Bond Market Update

Through mid-year 2025, the UST market has experienced meaningful volatility centered around economic uncertainty related to tariffs, the POTUS speaking openly of his dissatisfaction with FED chair Powell, and lingering inflation. In all, it was a perfect example of how the FED controls short rates and investors (the market) controls intermediate / long rates.

YTD as of June 30<sup>th</sup>, the yield on the 3 Month UST decreased only 3 basis points (bp) from 4.32% to 4.29% as the FED held the Fed Funds Rate steady at 4.25% - 4.50%. However, the yield on the 5 Yr UST decreased 59 bp from 4.38% to 3.79% as economic weakness and global uncertainty beat out inflation concerns and thus brought lower rates.

As mentioned above, we anticipate the FED will ease slowly in the 2<sup>nd</sup> half of 2025, putting downward pressure on ultra-short rates, but keeping them at historically attractive levels. We believe the 5 Yr UST could trade at higher yields as investors return their focus to the growing government debt load and inflation moving slightly higher, triggered by tariffs.

### Taxable Bond Market Update

The prominent headline affecting corporate bonds during the first half of the year was the tariff tantrum in April; however, while the bond market experienced short-term volatility over these past six months, the net change in yields and spreads were minimal as the President walked back most of the tariff threats. Corporate earnings, as measured by the S&P 500 Equal Weighted Index, continue to hover near record highs. For a fixed income investor, bond prices and returns are less sensitive to earnings growth than for equities – as long as corporations cover their obligations, investors will continue to collect fixed income cash flow.

The Trump administration has floated the idea of taking Fannie Mae and Freddie Mac public. This would return the entities to how they operated prior to the government takeover in September 2008. In the event this proposal is realized,

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President Trump has noted that the U.S. Government “will keep its implicit GUARANTEES”. The market is unclear on how exactly this would work, and while we do not want to speculate, we see little change in the inherent risk structure if the government continues to backstop the agencies. Thus, we see value in owning U.S. Agency bonds by capturing incremental spread above UST bonds for the same implied credit risk profile.

High Yield (HY) spreads, as measured by the iBoxx High Yield Index, remain marginally above their tightest level in the last twenty years. While off their true lowest level, spreads have been on a consistent downtrend since the market volatility in 2022 when yields and spreads across the spectrum rose in tandem. Beginning 2025, U.S. bankruptcies reached their highest level since 2010 and are exhibiting a disconnect with spreads – historically, spreads rise alongside increasing bankruptcies. Is the market mispricing risk and shrugging off bankruptcies? We remain vigilant and focus on the highest credit rating levels of the HY market while bankruptcies are concentrated in the lower rungs of the credit ladder. Electronic and high-speed trading allows nimble investors to take advantage of market volatility. Despite HY issuance falling year over year, HY bond trading volume in the 1<sup>st</sup> half hit a new record high. We believe HY investors should remain short duration focused and maintain an outsized focus on credit research.

During the first half of 2025, the Investment Grade (IG) U.S. corporate bond market saw interest rates fall alongside UST yields despite corporate spread widening. Looking forward, there are both opportunities and risks in the IG corporate bond market. With yields near 20-year highs, the current interest rate environment provides attractive yields for investors and provides a cushion against interest rate and credit risks within the marketplace. Market wide and industry wide risks to spreads include continued tariff headwinds and inflation reacceleration. We anticipate that the strong economic and business environment and a slow-moving FED will hold intermediate and long duration bond yields at attractive levels setting the stage for a strong second half of 2025.

### Municipal Bond Market Update

Municipal bonds showed resilience in the first half of 2025, navigating a complex environment characterized by persistent inflation pressures, shifting expectations for FED policy, and a surge in new issuance. While the year began with some headwinds, a solid rebound in the second quarter helped to steady yields and signaled growing investor confidence, setting the stage for a more constructive and opportunity-rich environment in the second half.

Thus far in 2025, we’ve seen a clear divergence between municipal and UST yields driven by rapidly evolving macroeconomic conditions. While the 7 Yr UST yield declined by 49 bp, 7 Yr AA rated municipal bond yields remained unchanged at 2.98%. The 2s-10s municipal yield curve steepened to 60 bp, its most pronounced slope since 2022. This steepening differential has made municipal bonds one of the few areas in fixed income where investors are being well compensated to extend duration. We believe these higher yields – approaching decade highs – offer attractive investment opportunities. Historically, current yield has been a strong predictor of future returns, and the existing setup bodes well for long-term performance.

One of the defining characteristics of the first half was the surge in new issuance, primarily driven by issuers flocking to market to get ahead of potential changes to the tax-exempt status of munis. Municipal bond issuance totaled approximately \$253 billion through late June, 16% higher than 2024’s record-breaking levels. YTD monthly average issuance was 10% higher than FY24, and 37% higher than 10-year average monthly issuance. June alone saw issuance rise 20% year-over-year, as issuers sought to get ahead of potential rate movements and fiscal deadlines. We expect issuance to remain high for the remainder of the year given higher infrastructure costs, although recent confirmation of the preservation of municipal bonds tax exemption could cause issuance to revert to more normalized levels. While this increase in supply put pressure on valuations, it also reflected a robust level of activity in municipal markets.

Credit fundamentals across the municipal landscape remain strong. According to Moody’s, municipal credit upgrades have outpaced downgrades for 17 consecutive quarters, which represents the longest such streak since 2008. The financial health of most state and local governments continues to benefit from conservative budgeting, healthy reserves, and still-elevated tax revenues.

Looking ahead, the direction of interest rates combined with supply and demand dynamics will shape valuations and returns. Additionally, the preservation of the federal tax exemption for municipal interest has removed a key source of



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policy risk and preserved the relative value of tax-exempt income. The current yield environment remains compelling with AA Rated 7 Yr yields finishing June at 2.98%, translating to a taxable-equivalent yield of 5.76% (assuming a 48.3% combined tax rate). This presents an attractive opportunity for long-term investors, especially as technical conditions improve and volatility creates opportunities to invest at favorable levels.

In summary, the municipal bond market navigated a complex first half of 2025 with resilience. While heavy issuance and uncertain monetary policy weighed on returns early in the year, a more balanced backdrop is emerging. With strong credit fundamentals, an improved rate outlook, and historically attractive yields, we believe municipal bonds remain a core component of a well-diversified, tax-sensitive fixed income strategy.

| <i>Data as of June 30, 2025</i> | <b>Taxable<br/>Fixed Income</b> | <b>Municipal<br/>Fixed Income</b> | <b>Opportunity<br/>Fixed Income</b> | <b>Enhanced Cash</b>   |
|---------------------------------|---------------------------------|-----------------------------------|-------------------------------------|------------------------|
| <b>Maturity</b>                 | 5.2                             | 7.8                               | 3.7                                 | 0.31                   |
| <b>Duration / Dur to Worst</b>  | 4.3                             | 6.2 / 4.3                         | 3.1                                 | 0.28                   |
| <b>YTM / YTW</b>                | 4.63%                           | 3.70% / 3.33%                     | 5.59%                               | 4.48% <sup>3</sup>     |
| <b>Taxable Equiv YTM/YTW</b>    |                                 | 7.16% / 6.44% <sup>1</sup>        |                                     | 4.67% <sup>1,2,3</sup> |
| <b>Coupon</b>                   | 4.21%                           | 4.56%                             | 5.75%                               | 1.76%                  |
| <b>Credit Rating</b>            | A-                              | AA                                | BB+                                 | A+                     |

Source: Carret / Bloomberg

|                            |     |     |     |     |
|----------------------------|-----|-----|-----|-----|
| <b>Sector Allocations:</b> |     |     |     |     |
| U.S. Treasury              | 14% | 1%  |     | 64% |
| Government Agency          | 11% |     |     | 3%  |
| Corporate - Inv Grade      | 68% | 1%  | 26% | 32% |
| Corporate - High Yield     |     |     | 64% |     |
| Preferreds                 | 5%  |     | 7%  |     |
| Convertible                |     |     |     |     |
| Municipal                  |     | 97% |     |     |
| Cash                       | 2%  | 1%  | 3%  | 1%  |

<sup>1</sup> Assumes a combined federal and state effective tax rate of 48.30% <sup>2</sup> Assumes a state tax rate of 7.50% <sup>3</sup> Yield on Invested Assets

### Taxable Fixed Income Strategy:

- The Taxable Fixed Income Strategy underperformed the Bloomberg Intermediate Gov't Credit Index during the year with a gross return of 3.8% and net return of 3.5% versus the index's return of 4.1%.
- The strategy's overweight exposure to corporate bonds detracted from relative performance to the index as spreads above U.S. Treasuries widened on economic uncertainty and tariff concerns.
- IG spreads, as measured by the 3-5 Yr A rated FactSet Index, widened by 7 bp during the year, increasing from 67 bp to 74 bp.
- IG spreads, as measured by the 3-5 Yr BBB rated FactSet Index, widened by 13 bp during the year, increasing from 92 bp to 105 bp.
- Strategy duration, at 4.3 Yrs, has been extended from 4.1 over the 1<sup>st</sup> H of 2025 to capture attractive longer-term yields. The elevated interest rate environment over the past three years has allowed for an increase in strategy duration whilst capturing and "locking in" attractive yield levels. We continue to analyze interest rate movement and capitalize on yield curve steepness to capture incremental yield.
- Average portfolio quality remained steady Y / Y at A-.
- The strategy's Yield to Maturity (YTM) decreased during the year from 4.98% on December 31<sup>st</sup>, 2024 to 4.63% at mid-year.
- The strategy's top three economic sectors are Financials, Energy, and Information Technology.

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- 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 68% to corporate bonds. Additionally, U.S. Agency bond valuations are attractive, boasting healthy spreads above UST. During the first half of the year, exposure to U.S. Agencies increased from 9% to an 11% 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 just above 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 outperformed the index YTD with a gross return of 1.1% and a net return of 0.9% while the Bloomberg Municipal Managed Money Intermediate Index returned 0.6%.
- Representative AA rated 5 Yr Municipal Bond yields fell by 13 bp YTD through June 30<sup>th</sup>. The index's YTM began the Yr at 2.98% and closed the half at 2.85%. Over the same period, 5 Yr UST yields fell by 59 bp.
- The municipal market experienced notable volatility during 1<sup>st</sup> H of 2025. However, the net YTD change in yields were quite modest. The yield stability combined with coupon-driven cash flow led to solid returns for the first half of the year.
- The 2 Yr-to-10 Yr municipal curve spread steepened during 1<sup>st</sup> H of 2025. The slope of the curve began the Yr at 31 bp and ended the 1<sup>st</sup> H at 60 bp. The greatest point of curve steepness for the period occurred on June 30<sup>th</sup> presenting a duration extension opportunity.
- The Strategy's duration-to-worst was 4.3 and the duration-to-maturity was 6.2 on June 30<sup>th</sup>. The Bloomberg Municipal Managed Money Intermediate Index duration-to-worst was 5.7 and the duration-to-maturity was 6.7 on June 30<sup>th</sup>. We continue to extend maturity and have opportunistically lengthened our duration-to-maturity from 5.2 to 6.2 over the past 12 months. Higher overall yields combined with positive fundamentals should enable us to continue to extend duration throughout the 2<sup>nd</sup> H of 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 YTM rose slightly YTD from 3.66% at year-end 2024 to 3.70% on June 30<sup>th</sup>. The strategy's Yield to Worst (YTW) also increased slightly from 3.28% to 3.33%.
- From the Taxable Equivalent Yield (TEY) perspective, municipals continue to offer very compelling relative yields. For example, a 3.70% Tax-Exempt municipal yield equates to a TEY of 7.16% for investors in the 48.3% combined tax bracket. The Crossover Rate (the tax rate where an investor would be indifferent between owning a municipal or a corporate bond) was 32.7% on June 30<sup>th</sup>.
- 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 global economic and geopolitical landscape.

### Opportunity Fixed Income Strategy:

- The Opportunity Fixed Income Strategy underperformed the Bloomberg Intermediate Gov't Credit Index during the 1<sup>st</sup> H of 2025, with a gross return of 3.9% and a net return of 3.5% versus the index's return of 4.1%. Our underperformance during the 1<sup>st</sup> H was a result of our short duration defensive positioning at the start of the year. During the 2<sup>nd</sup> Q, we extended duration and moved down the quality scale as opportunities related to the tariff volatility presented themselves. We are now outyielding our benchmark by 149 bp, setting up for a solid 2<sup>nd</sup> H.
- HY rates (as measured by the iBoxx HY Index) decreased from 7.52% on December 31<sup>st</sup> 2024 to 7.12% at mid-year, a decrease of 40 bp, but recall that the 5 Yr UST decreased 59 bp.
- HY spreads, while very volatile around the tariff announcement, widened only nominally during the 1<sup>st</sup> H of 2025, increasing from 314 bp on December 31<sup>st</sup>, 2024 to 333 bp at mid-year, a widening move of 19 bp.

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- IG spreads, as measured by the 3-5 Yr BBB rated FactSet Index, widened by 13 bp during the 1<sup>st</sup> H, increasing from 92 bp to 105 bp.
- The strategy's YTM decreased from 5.84% on December 31<sup>st</sup>, 2024 to 5.59% at mid-year.
- The strategy's top economic sectors are Consumer Discretionary, Financials, Energy, and Industrial.
- The strategy's duration increased during the half from 2.7 to 3.1 as we took advantage of a steepening yield curve and widening credit spreads around the April tariff announcement.
- Average portfolio quality held constant from the start of the year to mid-year at BB+; additionally, IG exposure at mid-year was 30%.
- At the start of the year, we were defensively positioned as credit spreads were at 20 Yr tight levels. As 2025 unfolded and volatility rose, we extended duration and increased exposure to HY. We remain focused on high quality HY companies. We believe further uncertainty in the 2<sup>nd</sup> H of 2025 will create additional opportunities. We have ample flexibility to add value as credit and interest rate opportunities arise – nearly 18% of the strategy holdings mature in the next 12 months and 59% of the strategy holdings mature in the coming 36 months.

### Enhanced Cash Strategy:

- Ultra-short-term interest rates were mostly flat during the 1<sup>st</sup> H, with modest declines in slightly longer maturities. The lack of significant moves in short rates comes as the FED left interest rates unchanged during the 1<sup>st</sup> H as it continues to monitor persistent inflation and the impacts of tariffs.
- The yield on the 6 Mo UST decreased 2 bp YTD, falling from 4.27% to 4.25%. The 1 Yr UST finished the 1<sup>st</sup> H yielding 3.96%, a decrease of 19 bp from December 31<sup>st</sup>, 2024.
- IG spreads, as measured by the ICE BofA 0-1 Yr A-AAA U.S. Corp Index relative to the ICE BofA 0-1 Yr UST Index, tightened YTD, decreasing from 55 bp to 29 bp. Tightening spreads, coupled with the strategy's 32% allocation to IG corporate bonds, resulted in price appreciation in client portfolios.
- Average portfolio quality remained constant at A+.
- Average duration increased YTD, moving from 0.20 Yrs to 0.27 Yrs as a result of increased exposure to longer duration corporates and U.S. Agency bonds.
- The strategy's YTM decreased from 4.60% to 4.34% in 1<sup>st</sup> H of 2025.
- The Enhanced Cash Strategy has outperformed the benchmark YTD, with a gross return of 2.14% and a net return of 1.83%, versus the ICE BofA 0-1 Yr UST Index return of 2.07%.
- In the back half of 2025, we anticipate gradual easing of ultra-short-term interest rates by the FED. Short rates should remain attractive relative to historical levels, continuing to offer investors meaningful cash management opportunities.

### 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.

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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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Due to various factors, including the passage of time and changing market conditions, content in this presentation may be outdated and no longer reflective of current conditions.