Co-Directors Equity

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Fund AUM (12/31/25)

$128.56 Million

Economy:

All signs point to higher interest rates; however, the old adage of "Don't Fight the Fed" can now be adapted to "Don't Fight the White House". With the economy on solid footing and GDP growing an estimated 2.3% in 2025 and expected to post a 2.2% gain in 2026, the Fed has been data dependent on its two main priorities: full employment and stable prices. While unemployment has risen as the labor market softens, inflation remains stubbornly elevated above the Fed's 2% target. Both statistics point to the "affordability" challenge that is increasingly front and center with both voters and the administration.

Our focus list for 2026 highlights the following: The U.S. Government debt continues to grow with persistent budget deficits, sticky inflation, solid economic growth, mounting geopolitical complexity, raging wars, and the Fed's independence being challenged. We believe investors should be paid for risk and thus, rates shouldn't trend lower. The White House's focus on affordability and subsequent rhetoric and policy initiatives could put a lid on interest rates through the midterms; thereafter, we anticipate interest rates could rise into year-end.

The economy is set for continued expansion in 2026, uncomfortably supported by the high-end consumer, in addition to AI and business capital spending (driven by new tax incentives for capital expenditures in 2026). Our "uncomfortable" view of consumer spending relates to the fact that 49.2% of total consumer spending was by the top 10% of income earners (2nd Q of 2025). Additionally, the wealthiest 20% of households in America control 70% of the wealth. We believe that consumer spending has been heavily supported by the wealthy.

National Municipal Market:

The 2025 municipal bond market was characterized by record-setting issuance and a late-year rally driven primarily by Fed interest rate cuts. The market experienced significant volatility, particularly in April, but ultimately rallied in the second half of the year. Yields of 5 Yr tax-exempt securities peaked shortly after the Liberation Day tariff announcements, a week that saw a dramatic and rapid increase in yields and volatility. Following the announcement, 5 Yr yields rapidly rose 81 bp only to drop 45 bp in the following days. After the initial market disruption, 5 Yr benchmark yields proceeded to decline consistently for the rest of the year. Despite significant volatility and policy concerns early in the year, strong credit fundamentals and robust investor demand provided a positive return environment for municipal bond investors.

The underlying credit quality of municipal issuers remained strong, with state and local governments benefiting from record high tax revenues and healthy reserve balances. Moody's reported upgrades outpaced downgrades by 1.9x in 2025, and defaults tracked well below 2024 levels. Municipal credit fundamentals continue to be strong while headline risks remain quiet. State and local revenues grew significantly over the past 5 years along with conservative budgeting to maintain rainy day funds, reduce debt, and improve pension and healthcare funding. Despite some recent spending of these hefty reserves, states ended fiscal year 2025 with over double the level of reserves that they had in fiscal year 2020. Some states have also improved controls by adding protections to limit spending rainy day funds and introducing requirements to build up reserves when revenues are strong.

New issue supply exceeded $580 Billion in 2025, marking a record year and surpassing the previous record year (2024) by 13%. This heavy supply was driven by pent-up capital needs for infrastructure projects and a desire by issuers to front-load borrowing ahead of potential tax policy changes. Positive demand has continued through 2025, with municipal funds recording $57 Billion of net inflows. The inflows recorded this year extend the net inflow streak to $100 Billion over the past two years.

A key turning point for 2025 was the passage of the "One Big Beautiful Bill Act" in July. The bill preserved the municipal tax exemption, alleviating investor concern that had caused some early-year anxiety and volatility. Looking ahead to 2026, primary market supply is expected to deliver another record year, with Covid-19 federal funding reserves running low and costly infrastructure projects continuing their need for funding across most municipal sectors.

Kansas Municipal Market:

The Kansas economy is expected to experience modest real growth throughout FY2026 and FY2027 according to the Kansas Legislative Research Department report issued on November 21, 2025. The report further explains that inflation is expected to continue its steady return to normal levels throughout the forecast period as nominal growth rates will continue to stabilize following several years of more rapid growth. Nominal Kansas Gross State Product (GSP) is expected to grow by 4.7% in 2026 and by 4.3% in 2027. The overall Kansas unemployment rate increased from 3.6% to 3.8% in 2025, and Kansas unemployment rates are forecast to remain at 3.8% in 2026 and 2027. The national unemployment rate is projected to remain above the Kansas rate. Kansas' labor force participation rate was 67% as of August 2025. An aging workforce continues to result in Kansas employers struggling to fill open positions as the number of job openings continues to exceed the number of unemployed individuals.

In an interview with the Kansas Reflector, Kansas State Governor Laura Kelly outlined the 2025 successes and looked ahead to 2026. Kelly said developing a budget for the fiscal year -starting July 1st - would be her primary focus, adding that "the Legislature pass a balanced, reasonable, sane budget that funds the important responsibilities of state government." Kelly said another objective was to sustain the push for economic development. The state's commitment to financially support relocation of the Kansas City Chiefs to a stadium in Wyandotte County and a headquarters in Johnson County was a "game-changer for our state", said Kelly. In the 2026 session, Kelly said she also would focus on finalizing a long-term plan for preserving and enhancing the state's water resources.

The Kansas municipal bond market concluded 2025 with strong positive performance, characterized by a significant rebound in the second half of the year following a weak first half. The Bloomberg Kansas Municipal Bond Index posted a YTD return of 4.7%. The state of Kansas and local governments ended 2025 with healthy reserves (rainy day funds), providing a buffer against normalizing revenue growth after the post-pandemic peak. In 2025, the Kansas municipal bond market held trend with national new issuance records. The state issued $4.3 billion in new bonds driven by infrastructure needs and new money projects, while strong investor demand, supported by attractive tax-equivalent yields and consistent inflows, led to a balanced, high-volume, market landscape.

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.

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