CARRET
Asset Management

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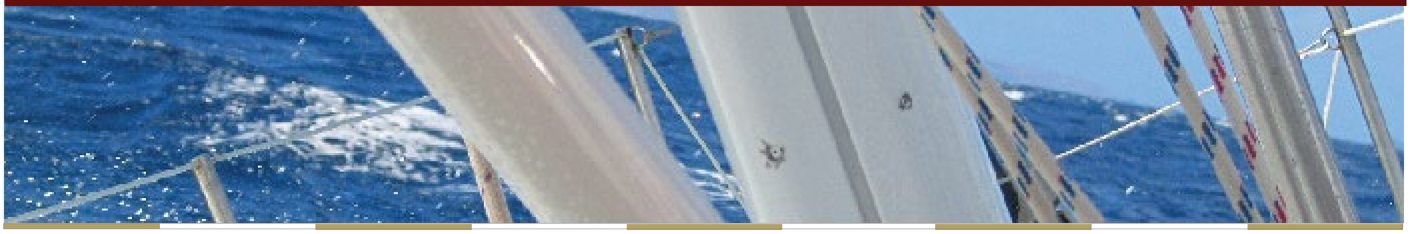
Carret Kansas Insights



Carret Kansas Tax-Exempt Bond Fund

Co-Directors Fixed Income

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Fund AUM (6/30/25)

$122.8 Million

The NOT SO BIG news of the 2nd quarter 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.

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.

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 2nd 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.

Municipal bonds showed resilience in the 1st 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 2nd quarter helped to steady yields and signaled growing investor confidence, setting the stage for a more constructive and opportunity-rich environment in the 2nd half.

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One of the defining characteristics of the 2nd quarter was the continued surge in new issuance, primarily driven by issuers flocking to market to get ahead of potential changes to the muni taxation and policy. 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. 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.

During the 2nd quarter of 2025, the Kansas economy experienced a notable rebound, with real gross domestic product (GDP) growing by 2.8%. This marked a turnaround from the sharp 3.3% contraction observed in the 1st quarter. Despite this improvement, Kansas continues to lag the national average GDP growth rate of 3.8%, placing it 41st among U.S. states in quarterly economic performance. The primary drivers of this growth were the finance and insurance sectors, wholesale trade, construction, transportation and warehousing, and professional and technical services.

The labor market in Kansas showed signs of stabilization, with the unemployment rate holding steady at 3.8% in June, below the national unemployment rate of 4.1%. Although this remained unchanged from May, it represented a notable increase compared to the 2.4% unemployment rate a year earlier. Meanwhile, labor force participation ticked up slightly to 66.4%, which remained higher than the national rate of 62.6%. Total non-farm employment stood at approximately 1.47 million jobs in June, reflecting a modest 0.7% year-over-year increase. The sectors seeing the strongest job growth were leisure, hospitality, and government, while employment in manufacturing and business services either declined or stagnated.

On the inflation front, price pressures remained elevated but showed signs of easing. The consumer price index (CPI) for Kansas rose 3.4% year-over-year as of mid-July, with core inflation (excluding food and energy) at 3.9%. Input costs continued to rise, prompting many businesses to consider future price increases. Nonetheless, overall inflation appeared to be moving toward a more sustainable path compared to peaks in prior years.

In summary, while Kansas made meaningful economic gains in the 2nd quarter of 2025, especially in recovering GDP and maintaining job growth, those improvements were tempered by softness in key sectors, persistent inflationary pressures, and subdued consumer confidence. Although agriculture and energy sectors face ongoing transformation and real estate shows signs of softening, underlying fundamentals continue to support a cautiously constructive outlook for the remainder of the year.

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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