Co-Directors Equity

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Fund AUM (6/30/26)

$136.5 Million

Economy:

On a recent June evening in New York City, U.S. Treasury Secretary Scott Bessent told a crowd at the Economic Club of New York's 250th Celebration dinner that "the bond market has taken out more governments than howitzers." Was the Treasury Secretary sending a message to the political leadership in DC to get the fiscal house in order? We find it interesting that the Treasury Secretary was addressing DC's spending problems. We believe this acknowledgment is important. We have been proactively discussing the ballooning domestic debt / deficit problem as we travel the country talking to our institutional clients. It's our #1 thesis on why we anticipate interest rates will stay elevated for longer (absent a recession – which is not on our horizon). With a $2 trillion annual deficit and nearly $40 trillion in debt, we are keenly aware of the fiscal challenges facing the U.S. and the fact that the U.S. bond market can force change – the howitzer: higher rates, escalating financing costs and in turn, more debt.

Trump's plan of generating $500B of tariff revenues, coupled with $500 billion of interest savings by pushing the Federal Reserve (FED) to lower short rates (so our debt can be financed at lower rates with short maturity bonds – a risk in itself), potentially could have trimmed $1 trillion from the annual deficit, almost halving the annual deficit. With tariffs being reset as a result of court challenges, the focus on lowering interest rates becomes even more important, explaining Trump's pressure on both former FED Chairman Jerome Powell and now Kevin Warsh. Recall that on January 1st, the market was anticipating 1-2 rates cuts this year; HOWEVER, elevated inflation is wreaking havoc on Trump's plan. Inflation remains WELL above the FED's 2% target and investors are now anticipating 1-2 rate HIKES this year - a result of many items, but we will focus on oil / energy prices and Artificial Intelligence (AI) capital expenditures (CapEx) for now.

We expect interest rates will have to stay elevated to attract investors and that the FED will want to stay politically neutral heading into the mid-term elections, therefore, our "best guess" at this point is that the FED will simply hold rates steady and work to implement other policy levers to restrain inflation – think quantitative tightening.

National Municipal Market:

Municipal Bonds had a solid 1st H of 2026 against a backdrop of global volatility and uncertainty. Supply remained elevated, with issuance reaching record levels and running 11% above last year's pace. Demand has remained exceptionally strong, reaching the second highest level in the past decade, allowing the market to absorb elevated supply while supporting positive returns. We believe elevated supply trends will continue. The combination of higher project costs (due to inflation), aging infrastructure, and federal funding policy uncertainties will drive issuance higher. We expect total issuance in 2026 to be roughly $600 billion and generally remain in balance with the demand side.

The AAA 2-10 Yr curve steepened slightly, in sharp contrast to the Treasury curve, which notably flattened. The Muni-to-Treasury yield ratio richened across the curve as Treasury yields rose more than muni yields during 1st H of 2026. Credit spreads are relatively tight compared to historical averages. Looking ahead, we expect spreads to remain rangebound with 2nd H of 2026 total return driven by coupon cash flows and reinvestments. Yields remain elevated by historical standards and currently sit in the 78th percentile over the past decade. We expect yields to remain higher for longer as inflation remains elevated and the potential for FED rate cuts has turned to potential rate hikes.

Muni credit fundamentals remain solid. Our municipal strategy continues to be structured with diversified ratings, maturities, coupons, and sectors. State tax collections and fund reserves continue to be robust, supported by healthy economic growth. Rating trends show upgrades outpacing downgrades by a wide margin for the muni market over the past 12 months.

Elevated supply balanced by strong demand, compelling tax-equivalent yields, and stable credit quality are key supporting factors setting up for a positive 2nd H of 2026.

Kansas Municipal Market:

The Kansas municipal market ended 2Q of 2026 from a position of strength, supported by sound underlying credit quality, steady capital investment, and a constructive technical environment for tax-exempt bonds. In May, Moody's Ratings revised its outlook on Kansas' ratings to positive from stable, citing the state's improving governance profile, including a trend of budgetary reserve fund maintenance and increasing pension contributions. On the fiscal side, Governor Kelly signed a $26.8 billion fiscal 2027 all-funds budget in April, including $10.7 billion in general fund spending.

Kansas municipal bond issuance remained active during 2Q of 2026, supported by ongoing infrastructure investment and capital improvement programs across state and local governments. Similar to the broader municipal market, Kansas issuers benefited from strong investor demand and elevated issuance volumes. General Obligation financings, continued to dominate the calendar, while education, transportation, and essential-purpose projects represented the remainder of new-money issuance. The mix of issuance favoring local municipalities over large state-level deals, mirrors the national backdrop. Muni issuance has been driven by rising infrastructure costs, the fading of post-pandemic fiscal support, and issuers' reluctance to delay funding needs despite elevated borrowing costs.

Credit fundamentals across Kansas issuers remained stable during the quarter, reflecting conservative fiscal management, healthy reserve balances, and resilient tax collections. Investor demand for high-quality municipal credits continued to line up with supply, resulting in relatively tight credit spreads and favorable spreads for Kansas issuers. While higher interest-rate volatility and ongoing federal policy uncertainty continued to influence market sentiment, the state's predominantly high-grade credit profile has enabled issuers to navigate these conditions effectively.

Looking at the second half of the year, we believe that the outlook for the Kansas municipal bond landscape is generally tied to national technical conditions rather than any state-specific concerns. We expect Kansas munis to enter 2nd H of 2026 with dependable, tax-efficient income and sound broad credit fundamentals. The combination of high starting yields and stable-to-improving credit generally supports continued investor demand for its municipal paper, as the broader muni market navigates heavier supply and FED policy uncertainty.

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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