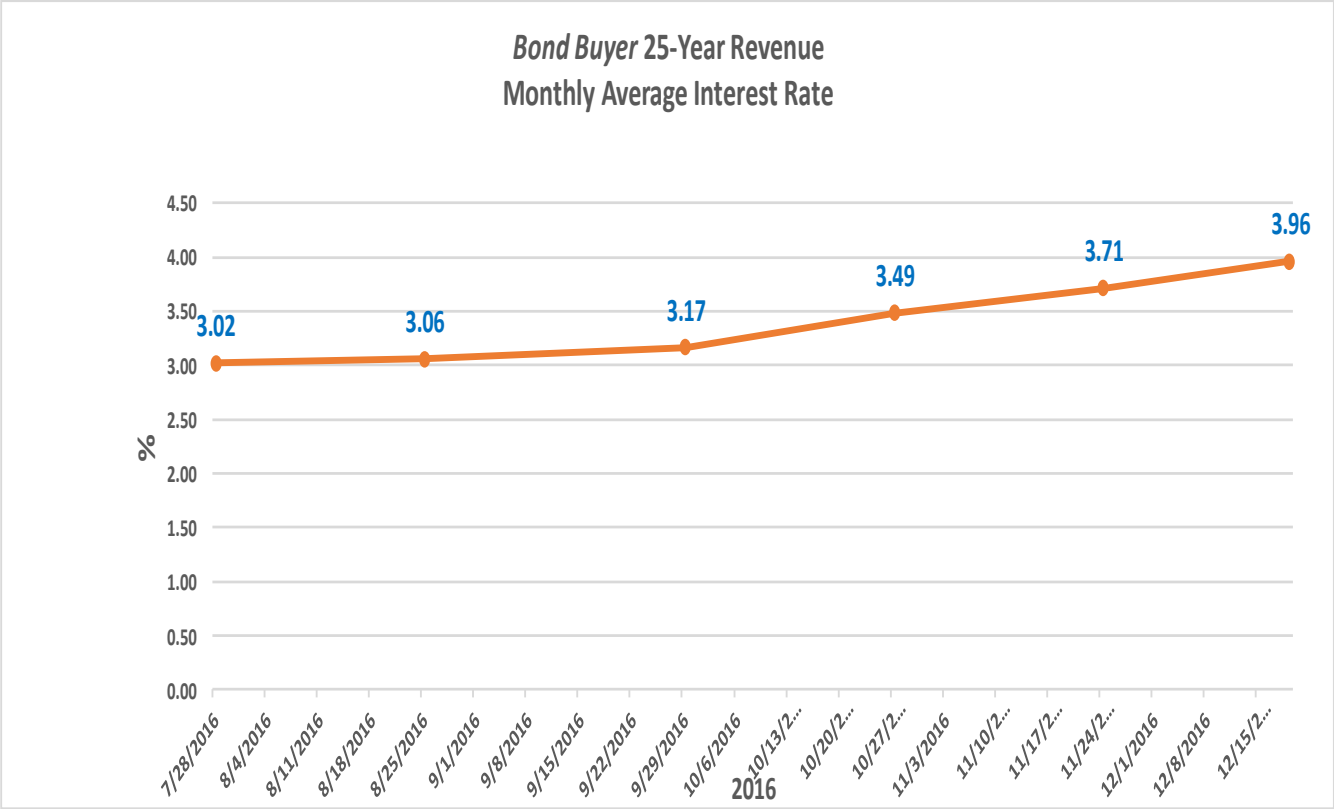
BOND BUYER INTEREST RATES YEAR-END 2016



Bond Interest Rates Rise for Americans as President Trump moves into White House

Following the November 8th election of Donald Trump as president, the yield on the ten-year Treasury bond rose from 1.73% to 2.36%. The Bond Buyer 20 index, which measures the average interest rate of 20 AA rated general obligation bonds that mature in 20 years, jumped from 3.27% on November 3rd to 4.03% on December 1st. The index currently is at 3.94% as of February 16th.

The justification for the upward trend is the belief that President Trump will push through a fiscal stimulus, through the use of tax cuts and infrastructure spending. This stimulus could potentially boost the economy, but it may result in the Federal Reserve to continue to raise short-term interest rates, as it did on December 14th to 0.75% from 0.50%. This rate hike could also result from a preserved threat of inflation in the near term. These three factors- faster growth, rising short-term rates and inflation- are usually key components resulting in higher bond yields.

President Trump wants to make significant tax cuts, lowering the highest individual tax bracket which is currently 39.6%. Under President Trump's current plan, the highest individual tax bracket would be lowered to 33%. This decrease in tax brackets rates would also lead to lower tax-equivalent yields on tax-exempt securities. The tax-equivalent yield tells the investor the breakeven rate a tax-exempt bond needs to yield relative to a taxable bond. These tax rate changes would not affect taxable instruments such as Treasuries, corporate bonds and mortgages. As a result, municipal bonds would need to sell off to adjust to the tax changes in order to maintain their value relative to other fixed income products.

President Trump wants to make infrastructure spending to improve roads, bridges, and airports a priority. Most of these projects are expected to be financed using municipal bonds and could lead to a significant increase in supply. However, there will be less demand if tax-equivalent yields are lower due to a decrease in income tax rates. When the supply goes up and demand goes down, bond prices would decrease and yields increase.

However, it is not certain how much of President Trump's agenda will be implemented, or whether economic growth will rebound or inflation rates will rise.