# BBH Intermediate Municipal Bond Fund

BROWN BROTHERS HARRIMAN

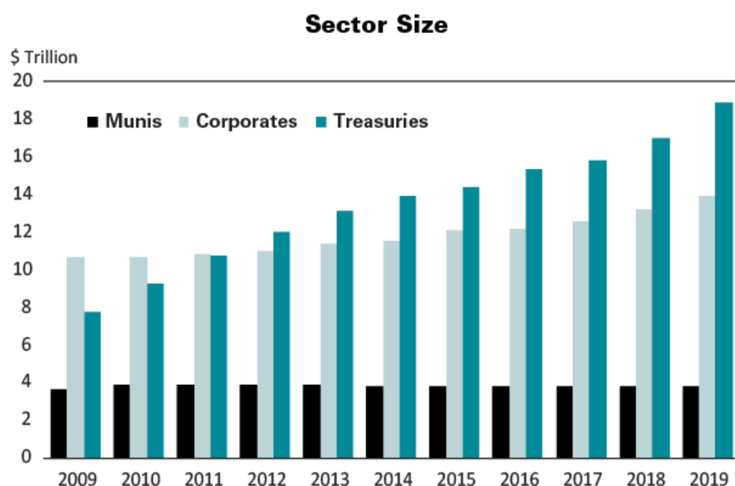
*Quarterly Fund Update / 4Q 2019*

## Forward Thinking

BBH Intermediate Municipal Bond Fund Class I ("the Fund") had a total return of 0.35% in December, compared to the return of 0.32% for the benchmark Bloomberg Barclays 1-15 Year Municipal Index. For 2019 as a whole, the Fund has returned 6.59% as compared to a benchmark return of 6.44%.

As we welcomed the new year, we officially closed the first full decade since the Financial Crisis. Despite the U.S. enjoying its longest economic expansion on record, with the S&P 500 equity index up over 250% and national unemployment at 3.5%, the U.S. bond market remains gripped by historically low yields. Many important trends emerged during the last decade to shape this outcome and alter the investment management landscape, including:

- Continued emergency monetary policy measures across the globe
- Zero-percent interest rates in much of the developed world
- Persistently low inflation, possibly delinked from the historical Phillips curve relationship
- Rise of nationalism, de-globalization, and attacks on central bank independence
- Growing recognition of the importance of sustainability and the emergence of Environmental, Social, and Governance (ESG) investing
- Rise of passive investing and persistent fee pressure



Data reported yearly from December 31, 2009 to December 31, 2019
Sources: Thomson Financial Services, Siebert, Brandford, Shank & Co., Lipper, and BBH Analysis

**Performance**
**As of December 31, 2019**

| | Total Returns | | Average Annual Total Returns | | | |
|---|---|---|---|---|---|---|
| | 3 Mo.* | YTD | 1 Yr. | 3 Yr. | 5 Yr. | Since Inception |
| **Class I** | 0.69% | 6.59% | 6.59% | 4.84% | 3.68% | 4.00% |
| **Class N** | 0.66% | 6.53% | 6.53% | 4.68% | 3.52% | 3.87% |
| **Benchmark** | 0.81% | 6.44% | 6.44% | 4.10% | 3.01% | 3.33% |

Class I Inception: 04/01/2014
Class N Inception: 04/01/2014

**Class I: Net/Gross Expense Ratio (%) 0.50 / 0.62**
**Class N: Net/Gross Expense Ratio (%) 0.65 / 0.91**

* Returns are not annualized.

*The Investment Adviser has contractually agreed to limit the Total Annual Fund Operating Expenses to 0.65% for Class N shares and 0.50% for Class I shares through February 29, 2020. The Expense Limitation Agreement may only be terminated during its term with approval of the Fund's Board of Trustees (the "Board").*

***Past performance does not guarantee future results, and current performance may be lower or higher than the past performance data quoted. The investment return and principal value will fluctuate, and shares, when sold, may be worth more or less than the original cost. For performance current to the most recent month-end please call 1-800-625-5759.*** *Fund shares redeemed within 30 days of purchase are subject to a redemption fee of 1.00%.*

The Bloomberg Barclays 1-15 Year Blend (1-17) Muni Index is a component of the Barclays Municipal Bond index, including bonds with maturity dates between one and 17 years. The Bloomberg Barclays Municipal Bond Index is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year. The index is not available for direct investment.

Sources: BBH & Co. and Bloomberg

Beyond these macro considerations, the municipal bond market had to weather several seismic shocks. Tax reform passed in 2017 significantly reduced the tax-value of municipals for corporate investors, capped state and local tax (SALT) deductions for households and eliminated the issuance of tax-exempt advanced-refunding bonds — effectively ending pre-refunded bonds ("pre-re's"). Unlike all other major bond market sectors which have grown rapidly, the municipal market stagnated during the last decade.

States and local governments have tightened their belts amid rising servicing costs for post-retirement benefits and growing voter reluctance for large debt-funded projects. As the nation's infrastructure ages, big spending plans remain inevitably around the corner and despite trillion-dollar national fiscal deficits, Federal support appears to be waning. Without flinching, the municipal market absorbed record-sized insolvencies in Detroit and Puerto Rico. Lastly, climate-related risk has been on the rise with wildfire liabilities dragging California's largest utility, Pacific Gas & Electric, into bankruptcy during 2019.

The municipal market ended 2019 strongly, generating a 7.5% return for the full maturity index and 6% for intermediates. Benchmark triple-A rated yields fell across the maturity spectrum by 80-90 basis points[1]. But the rally did not stop with high-grades. Voracious investor demand for lower-rated bonds drove even stronger results for tax-exempt triple-B and high yield debt. Emblematic of the credit rally, an index of Puerto Rico bonds returned 20%. We are value investors and prefer market volatility to an unrelenting credit rally. Nonetheless, the Fund fully participated in this year's rally and generated excess returns. While being patient and selective was not in vogue during 2019, the Fund was well-positioned.

Fund managers seeking to invest record inflows this year catalyzed a yield chase that helped drive the market to positive returns in 11 out of 12 months. In fact, fund flows were positive for each of 2019's 52 weeks. A disproportionate share of these flows was directed to high yield funds, which helps explain the outsize demand for credit-sensitive bonds. A continued dearth of tax-exempt issuance proved inadequate to satisfy this demand. Although $410 billion of new debt was issued, only $340 billion was tax exempt, barely enough to satisfy coupon and principal reinvestment, independent of fund flows.

Before 2017's tax-reform, periods of rapidly declining yields led to heavy refunding activity. In the past, issuers would come to market with new bonds at lower interest rates, use the proceeds to purchase government obligations and place them into escrow to defease older, higher interest debt. Today, municipal entities can no longer issue tax-exempt bonds to refund their existing debt prior to their maturity or call dates. This has practically eliminated pre-re's. Issuers have responded in three ways:

1. Issue debt with shorter-than formerly standard 10-year call options, such as five to seven years
2. Issue debt with delayed delivery dates (new bonds do not settle for up to 18 months in some cases)
3. Issue taxable debt

Of the three options, issuing taxable bonds was by far the most popular. The resulting surge in taxable municipal issuance was among the most surprising outcomes of the year. Excluding debt issued under the Build American Bond program, which offered Federal interest subsidies, 2019 set the record for taxable municipal issuance at just under $70 billion. As intermediate-to-long maturity rates fell to historical lows, it became economical for municipal entities to refinance by issuing taxable debt. Demand was generally strong as taxable bond investors looked for value beyond traditional investment grade and high yield corporate credit. As we begin the new decade, the vast majority of municipal bonds are still tax-exempt, but we expect taxable debt issuance to remain robust, absent a meaningful rise in interest rates.

## Leaving no stone unturned

We were able to steadily identify opportunities throughout the year — not an easy task given the year-long march to more expensive valuations. When yields decline and credit spreads narrow, good values become more difficult to find. We pride ourselves in staying patient. Whether it is during periods of investor exuberance like 2019, or the opposite times like the fall of 2018, our investment criteria and selectivity guide us and help keep our clients safe. Over the past few years, we executed the vast majority of our purchases in the secondary market, steering clear of the heightened competition for new issues. The primary market feeds our industry's giants. Finding attractive yields without sacrificing quality in smaller market niches has served our clients well over the years and we see no reason to deviate.

The municipal bond market remains dominated by household investors, many of whom value current income, straightforward general obligation bonds, and shorter maturities that possess less interest rate risk. Three areas of opportunities that we would highlight all avoid strong household demand either because of their lower coupons, complexity, somewhat longer maturities, or some combination of these factors. They are:

- Floating-rate notes
- Low coupon callable debt ("LoCo")
- State Housing Finance Authority debt

Floating-rate notes typically pay a lower rate of interest than household investors desire. Furthermore, floaters have been out-of-favor since the Federal Reserve (Fed) pivoted to an easing bias and reduced the Fed funds rate three times last year for a total of 75 basis points. Our two purchases here for the Fund were prepaid natural gas bonds backed by Morgan Stanley and JP Morgan that offered healthy effective spreads in the low-90 basis point range for a five-year average life, while comparable fixed-rate securities offered only 60 basis points of spread.

Last quarter, we described opportunities in LoCo's and we continued to add to the Fund's positions during the fourth quarter. Several examples include the State of North Carolina, the State of Virginia, and various Permanent Fund-backed Texas school districts. In general, these bonds possess coupon rates of 3% or lower, 10- to 15-year maturities and high double-A to triple-A credit ratings . Even under conservative volatility assumptions, these bonds offered about 60 basis points of effective spread. Outstanding bonds from these same issuers with 5% coupon rates and 10-year maturities offer only 5-10 basis points of spread, so you can see our attraction to the LoCo bond structure.

Lastly, the housing sector has afforded us opportunities in a range of different structures, from serial bonds that behave like traditional municipals, to PACs (planned amortization class securities) that behave like self-contained bond ladders, to longer-maturity term bonds, and pass-throughs. Near

[1] A unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument.

year-end, we added two large positions in Texas and Minnesota pass-throughs backed by government mortgage-backed securities that offered 8-10 years of seasoning and more than 100 basis points of effective spread. Unlike securities backed by new loans with heightened prepayment sensitivity, these securities are much more stable. With our seasoned collateral, homeowners have chosen not to refinance even though mortgage rates have been low for a long time. Many of the underlying loans are small and refinancing fees typically outweigh the benefits of lower rates.

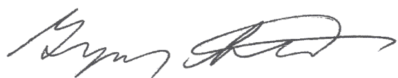
## The road ahead

Beyond reflecting on the past 10 years, it is a good time to think about the next 10. We derive little comfort from the record long U.S. economic expansion. Trends toward nationalism both here and abroad are inefficient from an economic standpoint, threatening not only real growth but also the relatively benign inflation environment we have enjoyed for over a generation. Demographic challenges associated with the aging of our population will be difficult to avoid. Many have long worried about the funding of public pension and retirement healthcare obligations. Even a record run in the stock market has not cured these issues. While weaker municipal governments have adeptly kicked the proverbial can down the road, we know from the Puerto Rico experience that this practice is not sustainable, nor does it represent good governance. Investors are also facing the risks associated with the repeal of the Affordable Care Act. Many not-for-profit hospitals would face material challenges should government reimbursement rates decline for Medicare and Medicaid patients. Despite these potential headwinds, we have confidence that our credit process will help keep our clients safe.

We also face rising risks associated with historically expensive valuations. The good news is that 2019's historic rally generated performance well-beyond our expectations. The more difficult news is that we have never begun a new year, let alone a decade, with such low yields which will serve as a dampener on future returns. To us, owning a generic market-like portfolio has never been interesting. Going forward, with today's valuations and growing risks, that generic portfolio has never looked worse. Protecting capital and generating excess returns through active management is more important than ever. Thoughtful, differentiated, and selectively-constructed portfolios are the best way we know to protect and grow our clients' assets.

Best wishes for a healthy, happy, and prosperous 2020 and thank you for your ongoing trust and confidence.

Sincerely,



*Gregory S. Steier*
*Fund Manager*

**Share Class Overview**
**As of December 31, 2019**

| | Overall Morningstar Rating ™ * | Ticker | CUSIP | Inception Date | Total Net Assets (mil) | NAV | 30-Day SEC Yield** (Subsidized) | 30-Day SEC Yield** (Unsubsidized) |
|---|---|---|---|---|---|---|---|---|
| **Class I** | ★★★★ | BBIIX | 05528C824 | 04/01/2014 | $349.9 | $10.72 | 1.45% | 1.41% |
| **Class N** | ★★★ | BBINX | 05528C816 | 04/01/2014 | $52.4 | $10.73 | 1.30% | 1.06% |

* Star ratings are based on risk-adjusted return. The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its 3-; 5- and 10-year Morningstar Rating metrics. There are 239 funds in the Muni National Interm category Overall Rating as of 12/31/2019.

** SEC yield is a calculation based on a 30-day period and is computed by dividing the net investment income per share earned during the period by the maximum offering price per share on the last day of the reported period.

**Credit Quality**
**As of December 31, 2019**

| | |
|---|---|
| Cash and Cash Equivalents | 2.7% |
| AAA | 28.2% |
| AA | 33.3% |
| A | 35.1% |
| BBB | 0.6% |
| BB | 0.0% |
| B or Lower | 0.0% |
| Not Rated | 0.0% |
| **Total** | **100.0%** |

Reported as a percentage of portfolio securities.

**Top 10 Holdings / Coupon / Maturity**
**As of December 31, 2019**

| | | | |
|---|---|---|---|
| Minnesota Housing Finance Agency | 2.470% | 01/01/2050 | 2.0% |
| Virginia State College Building Authority | 5.000% | 09/01/2027 | 1.9% |
| Texas State Department of Housing and Community Affairs | 2.835% | 09/01/2047 | 1.8% |
| Geisinger Health System, PA | 2.276% | 06/01/2028 | 1.7% |
| Michigan Qualified School Bond Loan Fund | 6.000% | 05/01/2029 | 1.7% |
| State of Massachusetts | 5.000% | 07/01/2026 | 1.4% |
| Public Energy Authority Of Kentucky (Peak) Gas Supply | 4.000% | 12/01/2049 | 1.4% |
| Massachusetts State Water Pollution Abatement | 0.000% | 08/01/2023 | 1.3% |
| New York State Energy Research and Development Authority | 2.375% | 07/01/2026 | 1.3% |
| Georgia Power Company, Plant Vogtle Project | 2.250% | 10/01/2032 | 1.2% |
| **Total** | | | **15.7%** |

Reported as a percentage of total portfolio.

**Sector Distribution**
**As of December 31, 2019**

| | |
|---|---|
| General Obligations | 29.5% |
| Pre-Refunded | 1.1% |
| Revenue | 69.5% |
| **Total** | **100.0%** |

Reported as a percentage of portfolio securities.

**Fund Facts**
**As of December 31, 2019**

| | |
|---|---|
| Number of Holdings | 217 |
| Number of Issuers Held | 113 |
| Effective Duration (years) | 4.52 |
| Yield to Maturity | 1.98% |
| Yield to Worst | 1.77% |

Holdings are subject to change. Totals may not sum due to rounding.

Credit Quality letter ratings are provided by Standard and Poor's, Moody's and Fitch and are presented as the higher of the three ratings. When a security is not rated by Standard & Poor's, Moody's or Fitch, the highest credit ratings from DBRS and Kroll may be used. Credit ratings reflect the credit quality of the underlying issues in the portfolio and not of the portfolio itself. Issues with credit ratings of BBB or better are considered to be investment grade, with adequate capacity to meet financial commitments. Issues with credit ratings below BBB are considered speculative in nature and are vulnerable to the possibility of issuer failure or business interruption.

Effective duration is a measure of the portfolio's return sensitivity to changes in interest rates.

Yield to Maturity is the rate of return the portfolio would achieve if all purchased bonds and derivatives were held to maturity, assuming all coupon and principal payments are received as scheduled and reinvested at the same yield to maturity. This figure is subject to change and is not meant to represent the yield earned by any particular security. Yield to Maturity is before fee and expenses.

Yield to Worst is the lowest yield an investor can expect when there is optionality on the bond (i.e., call or put, etc.). Yield to Maturity and Yield to Worst are before fees and expenses.

**This material is not authorized for distribution unless accompanied or preceded by a current Fund prospectus.**

Opinions, forecasts, and discussions about investment strategies represent the author's views as of the date of this commentary and are subject to change without notice. References to specific securities, asset classes, and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as recommendations.

Purchase and sale information provided should not be considered as a recommendation to purchase or sell a particular security and that there is no assurance, as of the date of publication, that the securities purchased remain in a fund's portfolio or that securities sold have not been repurchased.

**RISKS**

There is no assurance that this investment objective will be achieved.

Diversification does not eliminate the risk of experiencing investment losses.

Investing in the bond market is subject to certain risks including market, interest-rate, issuer, credit, and inflation risk; investments may be worth more or less than the original cost when redeemed. Income from municipal bonds may be subject to state and local taxes and at times the alternative minimum tax. The Fund also invests in derivative instruments, investments whose values depend on the performance of the underlying security, assets, interest rate, index or currency and entail potentially higher volatility and risk of loss compared to traditional stock or bond investments.

**For more complete information, visit www.bbhfunds.com for a current Fund prospectus. You should consider the fund's investment objectives, risks, charges and expenses carefully before you invest. Information about these and other important subjects is in the fund's prospectus, which you should read carefully before investing.**

Shares of the Fund are distributed by ALPS Distributors, Inc. and is located at 1290 Broadway, Suite 1100, Denver, CO 80203.

Brown Brothers Harriman & Co. ("BBH"), a New York limited partnership, was founded in 1818 and provides investment advice to registered mutual funds through a separately identifiable department (the "SID"). The SID is registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940. BBH acts as the Fund Administrator and is located at 140 Broadway, New York, NY 10005.

© 2020 Morningstar, Inc. All Rights Reserved. The information contained herein: (1) is proprietary to Morningstar; (2) may not be copied or distributed; and (3) is not warranted to be accurate, complete or timely.

Neither Morningstar nor its content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. The Morningstar Rating™ for funds, or "star rating", is calculated for managed products (including mutual funds, variable annuity and variable life subaccounts, exchange-traded funds, closed-end funds, and separate accounts) with at least a three-year history. Exchange-traded funds and open-ended mutual funds are considered a single population for comparative purposes. It is calculated based on a Morningstar Risk-Adjusted Return measure that accounts for variation in a managed product's monthly excess performance, placing more emphasis on downward variations and rewarding consistent performance. The top 10% of products in each product category receive 5 stars, the next 22.5% receive 4 stars, the next 35% receive 3 stars, the next 22.5% receive 2 stars, and the bottom 10% receive 1 star. The Overall Morningstar Rating for a managed product is derived from a weighted average of the performance figures associated with its three-, five-, and 10-year (if applicable) Morningstar Rating metrics. The weights are: 100% three-year rating for 36-59 months of total returns, 60% five-year rating/40% three-year rating for 60-119 months of total returns, and 50% 10-year rating/30% five-year rating/20% three-year rating for 120 or more months of total returns. While the 10-year overall star rating formula seems to give the most weight to the 10-year period, the most recent three-year period actually has the greatest impact because it is included in all three rating periods. The BBH Intermediate Municipal Bond Fund was rated against the following numbers of Muni National Interm category funds over the following time periods: 239 funds in the last three years and 215 funds in the last five years. With respect to these Muni National Interm category funds, the BBH Intermediate Municipal Bond Fund (Class I & Class N), received an Overall Morningstar Rating of 4 stars and 3 stars, respectively. Class I three- and five years periods received ratings of 4 stars and 4 stars, respectively. Class N three- and five-year periods received ratings of 4 stars and 3 stars, respectively.

**Not FDIC Insured** **No Bank Guarantee** **May Lose Money**

**BBH Fund Information Service: (800) 625-5759**