CALIFORNIA TAX FREE FUND

MARKET REVIEW

- The municipal market, as represented by the Bloomberg Barclays Municipal Bond Index, returned 2.90% during the first quarter of 2019.
- As risk assets rallied during the first quarter, lower credit quality tiers and longer dated bonds outperformed their higher quality and shorter term counterparts. This was a sharp reversal from the previous quarter which saw higher-rated bonds outperforming lower-rated issues amid investor concerns regarding slowing global growth, increasing market volatility, and the inversion of the front end of the Treasury curve. Notably, the high yield segment of the municipal bond market returned 3.83% during the quarter.
- Yields across the tax-free curve moved lower, with the intermediate and long portions experiencing the largest decreases in rates. On average, rates declined more than 35 basis points during the first three months of the year.
- Municipal bond funds extended their record year-to-date inflows to $22.5 billion, representing the best start to a year since Lipper established the data series in 1992.
- Using estimated total tax collections for full-year 2018, 46 states posted growth in tax revenue, with an average year-over-year gain of 7.2%, according to JP Morgan.

PORTFOLIO POSITIONING

- Relative to its benchmark, the Bloomberg Barclays Municipal Bond Index, the portfolio is underweight bonds in the 1- to 12-year maturity range, while maintaining an overweight to longer maturity bonds.
- The portfolio continues to maintain an overweight to revenue bonds, specifically in the transportation, health care, and industrial development sectors, given the dedicated income stream and favorable return prospects.
- The portfolio is overweight the lower tiers of the investment grade range due to the incremental yield advantage and solid credit fundamentals.

STRATEGY OUTLOOK

- Public policy developments at the federal and state level will continue to play a major role in the coming months. While the prospects for a comprehensive infrastructure plan have been dim for years, there is renewed interest from both political parties to engage in initial conversations that would determine the scale and viability of certain projects.
- We expect the higher tax-equivalent yields available on municipal bonds versus Treasuries and corporates, municipal bonds’ solid performance across ratings categories, and strengthening credit fundamentals to support the broader case for tax-free securities in today’s environment. While investor demand for municipals has increased, we continue to see attractive values on offer in the market.

A Note about Risk: The value of an investment in the Fund will change as interest rates fluctuate in response to market movements. When interest rates rise, the prices of debt securities are likely to decline, and when interest rates fall, the prices of debt securities tend to rise. High-yielding non-investment grade bonds involve higher risk than investment grade bonds. Adverse conditions may affect the issuer's ability to pay interest and principal on those securities. A portion of the income derived from the Fund’s portfolio may be subject to the alternative minimum tax. Any capital gains realized may be subject to taxation. Federal, state, and local taxes may apply. There is a risk that a bond issued as tax-exempt may be reclassified by the IRS as taxable, creating taxable rather than tax-exempt income. In addition, the Fund is subject to other types of risks, such as call, credit, liquidity, interest rate, and general market risks. The Fund may invest in bonds of issuers in Puerto Rico and other U.S. territories, commonwealths, and possessions, and may be affected by local, state, and regional factors. These may include, for example, economic or political developments, erosion of the tax base, and the possibility of credit problems. Stockholders should consult with their tax advisors for more specific information on taxation. U.S. Treasuries are backed by the full faith and credit of the U.S. government. The rate of return of a mutual fund investment, however, is not guaranteed and will fluctuate with changes in market conditions; therefore, there is a greater risk to your investment capital.

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and an investor cannot invest directly in an index.

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