Income Matters Today

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Taking a Calculated Risk

John Miller, portfolio manager.

Income Matters Today recently caught up with John Miller, head and chief investment officer of the high yield municipal credit team at First Eagle Investments. Miller, 57 years old, joined the firm in January after 27 years at asset manager Nuveen, where he also focused on municipal bonds. Miller's current duties include overseeing the fast growing $1.4 billion First Eagle High Yield Municipal Fund. Through June 7, the fund's total return for this year was just over 7%, well ahead of the Morningstar category average of about 2%. *An edited version of our conversation begins below.*

IMT: Thanks for being here, John. My first question is what sets high-yield municipal bonds apart as an attractive asset?

John Miller: If you look at historical data, the correlations between high-yield municipals and other asset classes are generally fairly low. The highest correlation is actually with investment- grade municipals.

So that's why I think about it as accessing a greater portion of the overall muni market. The other benefits, in addition to the low correlation and lower volatility per unit of risk, include that historically, the default rate of these bonds has been very manageable and lower than what the ratings would imply. In other words, BB-rated municipal bonds have a default rate that's similar to A-rated corporate bonds.

(Editor's note: the former is below investment grade while the latter is investment grade.)

BBB-rated municipal bonds, [which are investment grade], are closer to very high quality corporate bonds, in terms of their historical default rate, and their historical recovery rates are also fairly high at an average of 66 cents on the dollar over the last 53 years.

The other benefits of high-yield municipal bonds are that they are similar to municipal bonds themselves, of course, because the tax exemption and the consistency of the cash flow. Another positive attribute is that municipal bond interest is not subject to federal taxes.

It sounds like the default rates of municipal high-yield bonds are closer together than, say, those of corporate investment grade and high-yield credits?

Correct. The IG [investment-grade] muni default rate is extremely low. Below the BBB-minus-rated muni bonds, that default rate ticks up slightly -- but it does not increase as much as corporate bonds of the same rating category. And it does not increase as much as one would expect for the additional yield that you're getting.

Generally speaking, what kinds of yields are you seeing in the high-yield municipal bond universe? Ditto for credit spreads, which is the difference between, say, a yield on a high-yield bond and one that's investment grade?

The credit spreads for high-yield munis have narrowed over the course of the year. But it's highly uneven. That's due to some of the larger indentures within the high-yield municipal industry. I'm referring to multibillion dollar bonds, mostly from the restructured bonds of the Commonwealth of Puerto Rico and certain tobacco securitization bonds, which are highly liquid and always trading. Those bonds have actually performed fairly well, amid interest rate volatility, and their spreads have narrowed. They make the index look like there's been more narrowing of credit spreads so far this year.

But there's a great deal of dispersion around the mean. In terms of very broad brushstrokes, spreads on some bonds in high yield can be as narrow as 175 basis point, or 1.75 percentage points. But they can also be as wide as 400 basis points, or four percentage points. When I make that comparison, in basis points, I'm comparing the yield on a high-yield municipal bond to, say, the same spot on the AAA [investment grade] municipal bond benchmark.

What parts of the market are you focusing on?

We are always looking for opportunities that we think can have an improving credit trajectory, that can be resilient in an economic downturn from a revenue and credit perspective, and that are building essential infrastructure for a local community.

At the same time, we're looking at the bottom up in terms of blocking and tackling. That relates to a security's features such as pricing, coupons, call features, and, of course, the credit spread to the AAA bonds and so forth. That has caused us to gravitate to a few different areas, including healthcare, both hospitals and senior living facilities. It also includes charter schools, transportation facilities, and the land-backed, or the community development district, sector. There's also multifamily housing.

How concerned are you about a recession and its potential impact on these bonds?

First of all, the muni credit trajectory tends to lag the broader economy, and it tends to be more resilient, because a lot of the revenue streams are very sticky in a downturn. And there are very few instances where municipal revenues take a sharp downturn.

What are these revenue streams to service the debt of these bonds?

For municipal bonds in general, they are personal income tax collections, sales tax collections, property tax collections and corporate income tax collections. There's also landing fees at airports; costs of healthcare at hospitals; water, sewer and electric bills; tolls on bridges and roads; and train tickets. You can track those revenues on a macro, state and city level. We haven't seen any downturn yet.

Now, we are keeping an eye on that. But these downturns in the municipal area tend to be smaller. And they tend to be more lagged in time. So I don't think we're going to see much of a downturn in actual revenues this year, even if the timelier indicators of the economy -- like unemployment claims -- might be more volatile. But for that to translate into a diminution of property tax collections would take a very long time.

Presumably, John, you diversify the portfolio partly against any kind of a downturn, right?

Yes, no question. We're looking to mitigate by investing in sectors such as healthcare, education, transportation, and real estate development. I'm not going to say there's no cyclical influence. But there's a mitigation of how cyclical they are. And you can also diversify by location and by investing in things that are growing systematically or on a secular basis. There are ways to mitigate against the cyclical sensitivity.

How are you generating the fund’s returns – income, price appreciation or both?

The institutional share class, which trades under the ticker FEHIX, recently had a total return of 7.05% year to date. About one-third of it is from income and two-thirds is from price appreciation. So the annualized income component is 6%. And we're almost halfway through the year. So 5/12ths of 6% is the income component. The rest comes from price appreciation of our holdings.

One of your holdings involves the Brightline, a passenger rail line in Florida. Could you elaborate?

It's in our top 10 holdings of the fund. It is an example of a non-rated bond that has become an investment grade rated bond, at least at the senior level. It’s a project that I've been following for about 10 years. It the first high-speed passenger rail developed from private interests and predominantly private money, with bond funding from investors, in at least 100 years. Ten years ago, it had no service available but was purely under construction. It was running on freight rails, which the primary equity sponsor had purchased. Fortress Investment Group, a private equity firm with an infrastructure focus, is the primary equity sponsor and the visionary behind the project.

They put a significant amount of equity, planning, management and effort into this project. But as of today, after about 10 years of development, the high-speed passenger rail services runs from the middle of downtown Miami to Aventura, which is in North Miami, and then to Fort Lauderdale. It then goes to Boca Raton and West Palm Beach. Then it accelerates and goes all the way up to the Orlando International Airport. Orlando opened in late August of last year, which was a big, big achievement for the project.

Actually, back in March of this year, the Brightline carried more passengers than Amtrak’s Acela line, which runs between Boston, New York and Washington, D.C. -- and is perhaps the most popular high-speed line in the country. So the Brightline is gaining more notoriety, now that it goes all the way between Miami and Orlando.

The bonds themselves have had a refinancing transaction this year, and that's where they went from being non rated, which is generally considered below investment grade. Now, at least $2.2 billion of the new Brightline issue is rated BBB-, [the lowest rung of investment grade], by Standard & Poors. And a chunk of those are insured by Assured Guarantee, effectively giving them a AA rating.

What kind of yields are you seeing on those bonds?

For the new bonds, it is sort of a complicated answer because they are in tranches that have mid to upper 4% yields for the senior tranches. But then there's a subordinated tax-exempt tranche that yields around 10%.

Thanks for spending time with us, John.

https://lawrencestrauss.substack.com/

Source: Morningstar 2024, Bloomberg, First Eagle Investments

The First Eagle High Yield Municipal Fund was known as the First Eagle High Income Fund prior to December 27, 2023.

High Yield Municipal Fund Performance

Average Annual Returns

Data as of 31-Mar-2024

	New Strategy (YTD)[1]	1 Year	5 Years	10 Years	Since Inception	Gross Expense Ratio[2]	Net Expense Ratio	Adjusted Expense Ratio[3]	Fund Inception Date
Class A (FEHAX) w/o load	4.20%	10.38%	3.68%	3.12%	4.36%	1.53%	1.25%	0.85%	Jan 3, 2012[4]
Class A (FEHAX) w/ load	-0.46%	5.36%	2.72%	2.65%	3.97%	1.53%	1.25%	0.85%	Jan 3, 2012[4]
Class C (FEHCX)	3.15%	8.57%	2.93%	2.37%	3.58%	2.28%	2.00%	1.60%	Jan 3, 2012[4]
Class I (FEHIX)	4.37%	10.62%	3.97%	3.42%	6.67%	1.28%	1.00%	0.60%	Nov 19, 2007[4]
Class R6 (FEHRX)	4.54%	10.80%	4.03%	-	3.79%	1.28%	1.00%	0.60%	Mar 1, 2017[4]
S&P Municipal Yield Index	1.95%	7.80%	3.00%	4.48%	4.52%	-	-	-	-
Bloomberg US Corporate High Yield Index	1.47%	11.15%	4.21%	4.44%	6.34%	-	-	-	-

The performance data quoted herein represents past performance and does not guarantee future results. Market volatility can dramatically impact the fund's short term performance. Current performance may be lower or higher than figures shown. The investment return and principal value will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Past performance data through the most recent month end is available at www.firsteagle.com or by calling 800-334-2143. The average annual returns are historical and reflect changes in share price, reinvested dividends and are net of expenses. "With sales charge" performance for class A shares gives effect to the deduction of the maximum sales charge of 2.50%. The average annual returns for Class C shares reflect a CDSC (contingent deferred sales charge) of 1.00% in the year-to-date and first year only. Class I shares require $1MM minimum investment and are offered without sales charge. Class R6 shares are offered without sales charge. Operating expenses reflect the Fund's total annual operating expenses for the share class of the Fund's most current prospectus, including management fees and other expenses.

1. John Miller started as lead portfolio manager of the Fund beginning 2-Jan-2024.
2. First Eagle Investment Management, LLC (the ''Adviser'') has contractually agreed to waive and/ or reimburse certain fees and expenses of Classes A, C, I, and R6 so that the total annual operating expenses (excluding interest charges on any borrowings, taxes, brokerage commissions and other expenses incurred in placing orders for the purchase and sale of securities and other investment instruments, acquired fund fees and expenses, dividend and other expenses relating to short sales, and extraordinary expenses, if any) (''annual operating expenses'') of each class are limited to 0.85%, 1.60%, 0.60%, and 0.60% of average net assets, respectively. Each of these undertakings lasts until 28-Feb-2025 and may not be terminated during its term without the consent of the Board of Trustees. The Fund has agreed that each of Classes A, C, I, and R6 will repay the Adviser for fees and expenses waived or reimbursed for the class provided that repayment does not cause annual operating expenses (after the repayment is taken into account) to exceed the lesser of: (1) 0.85%, 1.60%, 0.60%, and 0.60% of the class' average net assets, respectively; or (2) if applicable, the then-current expense limitations. Any such repayment must be made within three years after the year in which the Adviser incurred the expense.
3. The Adjusted Expense Ratio excludes certain fees and expenses, such as interest expense and fees paid on Fund borrowings and/or interest and related expenses from inverse floaters. The Fund is currently in a "ramp-up" period, during which it may not be fully invested, and certain of these expenses may change over time.
4. Effective 27-Dec-2023, the Fund changed its name and principal investment strategy. Performance for the periods prior to 27-Dec-2023 is based on the investment strategy utilized by the Fund at those times. The Bloomberg US Corporate High Yield Index was the benchmark for the prior strategy.

Top Ten Holdings[5]

Issuer	Rating[6]	Allocation
Florida Dev Fin Corp Surface Transn Fac Rev 7.375% 01-Jan-2049	NR	2.99%
Florida Dev Fin Corp Rev Variable 1-Jul-2057	NR	2.67%
Olney Tex Hamilton Hosp Dist 6.25% 15-Sep-2054	NR	2.39%
New Hope Cultural Ed Facs Fin Corp Tex Sr Livingrev 5.5% 01-jan-2057	NR	2.20%
Public Fin Auth Wis Tax Increment Rev 8.0% 15-jun-2042	NR	1.93%
Arkansas St Dev Fin Auth Indl Dev Rev 7.375% 1-Jul-2048	NR	1.66%
Suffolk Regl Off-track Betting Corp N Y Rev 6.0% 01-dec-2053	NR	1.61%
Lucas Cnty Ohio Hosp Rev 5.25% 15-Nov-2048	BB	1.58%
Cscda Cmnty Impt Auth Calif Essential Hsg Rev 4.0% 01-dec-2058	NR	1.23%
Spring Vy Cmnty Infrastructure Dist No 1 Idaho Spl Assmt 6.25% 01-sep-2053	NR	1.21%
Top Ten Holdings as a Percentage of Total Net Assets		**19.48%**

5. Top 10 holdings represent high yield municipal securities only.

6. A credit rating as represented here, is an assessment provided by a nationally recognized statistical rating organization (NRSRO) or credit worthiness of an issuer with respect to debt obligations, including specific securities, money market instruments, or other bonds. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. Not Rated (NR) indicates that the debtor was not rated and should not be interpreted as indicating low quality. For more information on the Standard & Poor's rating methodology, please visit standardandpoors.com and select "Understanding Ratings" under Rating Resources.

The holding Brightline mentioned, represent the following percentage of the toal net assets of the First Eagle High Yield Municipal Fund as of May 31st, 2024. 10.07% of Florida Dev Fin Corp Rev Var.

Portfolio holdings are subject to change and should not be considered a recommendation to buy or sell securities.

Not a guarantee of future portfolio composition. Current and future portfolio holdings are subject to risk.

The specific securities identified and described are not representative of all of the securities purchased, sold, or recommended for client accounts. It should not be assumed that an investment in the securities identified has or will be profitable. Actual holdings will vary for each client and there is no guarantee that a particular client's account will hold any or all of the securities listed.

Credit rating as represented here, is an assessment provided by a nationally recognized statistical rating organization (NRSRO) or credit worthiness of an issuer with respect to debt obligations, including specific securities, money market instruments, or other bonds. The fund itself has not been rated by an independent rating agency. Credit quality ratings on underlying securities of the fund are received from S&P, Moody's and Fitch and converted to the equivalent S&P major rating category. This breakdown takes the median rating of the three agencies when all three agencies rate a security the lower of the two ratings if only two agencies rate a security and one rating if that is all that is provided. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. Not Rated indicates that the debtor was not rated and should not be interpreted as indicating low quality. Below investment-grade is represented by a rating of BB and below. Ratings and portfolio credit quality may change over time.

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Indices are unmanaged and do not incur management fees or other operating expenses. One cannot invest directly in an index.

The High Yield Muni Category is represented by the Morningstar High Yield Muni category, which includes High yield muni portfolios that invest at least 50% of assets in high-income municipal securities that are not rated or that are rated by a major agency such as Standard & Poor's or Moody's at the level of BBB (considered speculative in the municipal industry) and below.

Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

Bloomberg High Yield Municipal Bond Index measures the non-investment grade and non-rated US tax-exempt bond market. It is an unmanaged index made up of dollar-denominated, fixed-rate municipal securities that are rated Ba1/BB+/BB+ or below or non-rated and that meet specified maturity, liquidity, and quality requirements.

S&P 500 Index is a widely recognized unmanaged index including a representative sample of 500 leading companies in leading sectors of the US economy and is not available for purchase. Although the Standard & Poor's 500 Index focuses on the large-cap segment of the market, with approximately 80% coverage of US equities, it is also considered a proxy for the total market.

S&P Municipal Yield Index measures the performance of high yield and investment grade municipal bonds. Index constituents are market value-weighted and adjusted for credit rating and concentration limits.

Diversification does not guarantee investment returns and does not eliminate the risk of loss.

Tranches are pieces of a pooled collection of securities, usually debt instruments, that are split up by risk or other characteristics in order to be marketable to different investors. Tranches carry different maturities, yields, and degrees of risk—and privileges in repayment in case of default.

Risk Disclosures

All investments involve the risk of loss of principal.

The transition of the First Eagle High Yield Municipal Fund (the "Fund") from the First Eagle High Income Fund was effected on or about December 27, 2023. There continues to be increased operational risks associated with the transition, during which the Fund has acquired new and additional trading and counterparty relationships, new and additional borrowing and leverage arrangements, and new and additional capabilities for the management of derivatives and may require more.

Beyond the inherent risks of transition and associated complexity, because some, but not all of the required or desirable operational capabilities and investment and counterparty arrangements were fully implemented prior to the effective date of the transition, until such time as that occurs, the Fund's flexibility to fully implement its new objective and strategies may continue to be limited during the transition period. During the transition period, it is expected that the Fund will not be as invested in income-producing securities that are exempt from regular federal income taxes as will be the case once the transition is complete. As a result, a higher percentage of the Fund's dividends are expected to be ordinary dividends rather than "exempt-interest dividends" during the transitional phase. Funds that invest in bonds are subject to interest-rate risk and can lose principal value when interest rates rise, while they typically increase their principal values when interest rates decline. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner, or that negative perception of the issuer's ability to make such payments may cause the price of that bond to decline.

The Fund may invest in high yield, fixed income securities that, at the time of purchase, are non-investment grade. High yield, lower rated securities involve greater price volatility and present greater risks than high rated fixed income securities. High yield securities are rated lower than investment-grade securities because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities. High yield securities involve greater risk than higher rated securities and portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. Municipal bonds are subject to credit risk, interest rate risk, liquidity risk, and call risk. However, the obligations of some municipal issuers may not be enforceable through the exercise of traditional creditors' rights. The reorganization under federal bankruptcy laws of a municipal bond issuer may result in the bonds being cancelled without payment or repaid only in part, or in delays in collecting principal and interest. All investments involve the risk of loss of principal.

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