THE VECTOR GROUP *at* MORGAN STANLEY

Vec·tor (VEK-ter) n.
magnitude and direction
—Miriam Webster Dictionary

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As of December 31, 2017

Morgan Stanley

Vector Municipal Bond Strategies

Investment Objective

Vector Municipal Bond portfolios are structured for each individual client with an objective to provide federal tax free income and low volatility. The portfolios are suitable for investors who are interested in a steady income stream and a low correlation to equities. Typically, the portfolio will be fully invested with high quality bonds from different sectors of the economy and should be considered a core fixed income strategy.

Investment Process

Both top-down and bottom-up approaches are employed. Security selection is paramount in the strategy. Factors such as tax collection data, revenue tendencies, regional employment developments and political and regulatory trends are considered when buying bonds. Sector rotation is also considered, as we currently favor essential service revenue bonds from water/sewer, transportation/ highway, education, and health care sources. General Obligation bonds are currently out of favor-a marked difference in perception from just a few years ago.

Because of unusual current valuations, yield curve positioning and duration management play a significant role. Coupon, call date, maturity and general bond structure are an important ingredient of portfolio construction. Zero coupon bonds are often paired with high coupon securities to achieve maximum return.

Portfolio Characteristics

Weighted Average Duration	7.5 years
Weighted Average Coupon	3.75%
Weighted Average Moody/S&P Rating	A2/A+

Sector Breakdown

Highway & Transit Revenue	32%
Sewer & Water revenue	9%
Ad Valorem Property Tax	23%
Charter School aid	12%
Natural gas & Electric Power revenue	7%
Fuel Sales Tax revenue	5%
Sales Tax revenue	4%
Airport revenue	4%
Hospital revenue	2%
Other	2%

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Interest in municipal bonds is generally exempt from federal income tax. However, some bonds may be subject to the alternative minimum tax (AMT). Typically, state tax-exemption applies if securities are issued within one's state of residence and, local tax-exemption typically applies if securities are issued within one's city of residence.

Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating, or creditworthiness, causes a bond's price to decline. Finally, bonds can be subject to prepayment risk. When interest rates fall, an issuer may choose to borrow money at a lower interest rate, while paying off its previously issued bonds. As a consequence, underlying bonds will lose the interest payments from the investment and will be forced to reinvest in a market where prevailing interest rates are lower than when the initial investment was made. NOTE: High yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues.

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CRC# 1581958