Municipal Bonds

So Far, So Good, But Watch for Cracks

An imbalance in supply and demand helped munis rally.

Market conditions remain firm for both tax-exempt and taxable municipal bonds. Strong retail demand continues to support tight tax-exempt valuations, while taxables have rallied in line with other risk assets. There have been no major developments on the credit front, although we are monitoring potential revenue/expense mismatches that foreshadow structural deficits.

Sector Commentary

- Tax exempts have held up well so far in 2024, despite a 42 percent increase in new issuance and 50–60 basis point rise in long Treasurys. Tax exempt/Treasury yield ratios are essentially unchanged through April, with 5/10/30-year durations hovering around 61 percent, 60 percent, and 83 percent respectively.
- Typical seasonal volatility in March and April occurred as supply surged, while the ebb in principal and interest payments was subdued by persistent demand from separately managed accounts (SMA) and net inflows into mutual funds.
- Taxable spreads experienced some turbulence, with spreads on Build America Bonds (BAB) widening when a few large issuers exercised their Extraordinary Redemption Provision (ERP) calls.
- Taxables have mostly tightened on the year, as risk assets rallied and a 32 percent decline in issuance caused an imbalance in supply and demand.

Investment Themes

- At current ratios and spreads, we prefer taxables over tax exempts. We believe market participants have looked past November and projected federal deficits—and consequently tax rates—to persist regardless of the electoral outcome, and have decided to lock in tax exempt yields. This implicit bet on the tax code likely keeps tax exempt ratios compressed in the near term.
- Improvements to credit fundamentals have slowed, with most states reporting stagnant tax receipts. We are monitoring situations with declining revenues and rising expenses, which foreshadow structural budgetary deficits.
- Labor tends to be the largest expense for municipal obligors, and four states have set minimum salaries for K-12 teachers, with five more in the planning stage. To maintain fiscal prudence, new spend minimums should be offset by sustainable new sources of revenue or reductions in other expenditures.

By Allen Li and Michael Park

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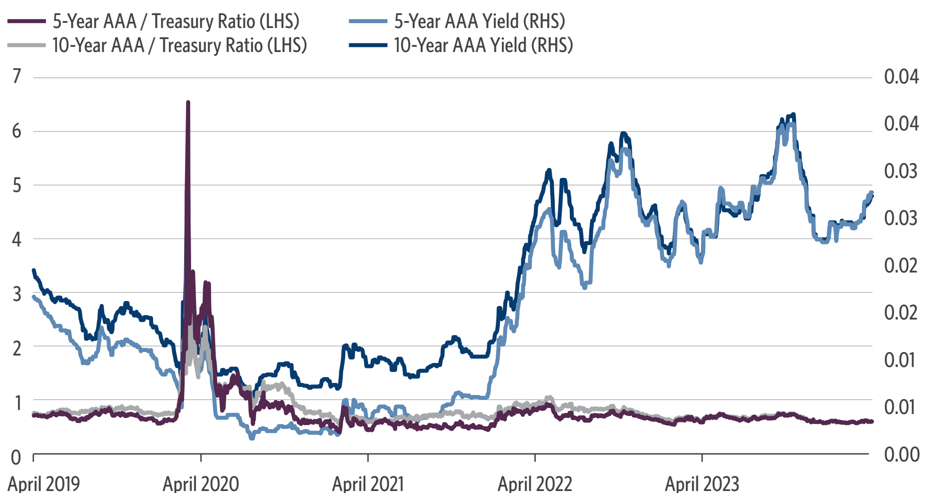
Tax Exempt Munis Have Held Up Well So Far in 2024



Source: Guggenheim Investments, Municipal Market Monitor. Data as of 4.19.2024. Past performance does not guarantee future results.