

Municipal Bonds

Some Relief from Technical Headwinds

Improving technicals and steady credit fundamentals should support munis in the near term.

As we forecasted in the third quarter outlook, technical headwinds since the end of the summer have led to negative total returns in tax exempt bonds. Treasury volatility and a steep drop off in principal and interest payments have reset yields higher. Institutional buyers have traded the market cautiously, keeping cash levels steady by matching new issue purchases with sales of existing positions. Conversely, individual investors—especially those with separately managed accounts—have become much more active as tax-exempt yields have shifted higher. When new issues run separate retail and institutional order periods, we have seen increased instances of retail taking down more than half of the deal, leaving a smaller than expected allotment for institutional buyers.

Traditional municipal sectors such as local government and essential utilities retain solid credit fundamentals. S&P has upgraded 641 credits and downgraded just 199 in 2023, a 3:1 ratio. Default rates rose from 0.03 percent in 2022 to 0.04 percent in 2023, with defaults concentrated in nursing homes and hospitals. Sales tax and

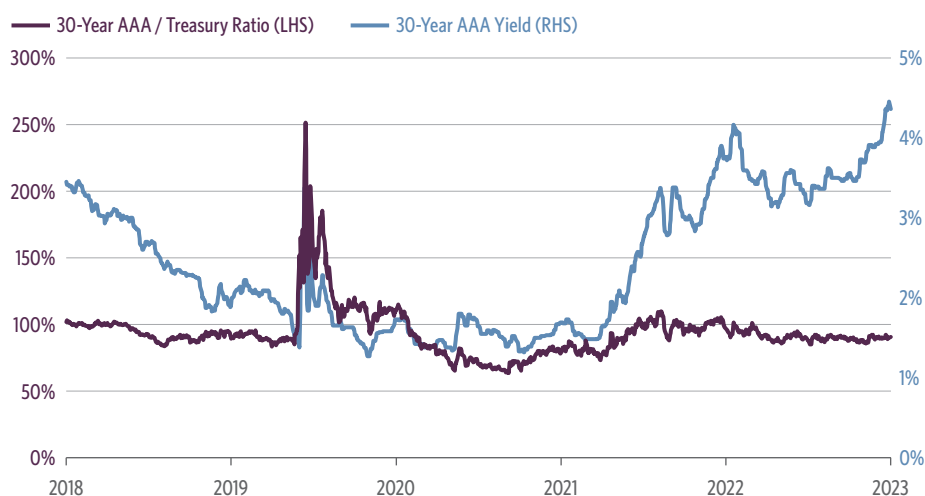
corporate tax receipts have trended positive, while individual income tax receipts are down, with a caveat that a few states pushed filing deadlines from April to October. Given most domestic equity indexes are positive year to date, capital gains tax collections should trend higher than 2022, providing upside to revenues over the next one to two quarters.

Despite the reset in valuations, the ratios of tax-exempt yields to Treasury yields are still inside their one-year wides, with the 30-year AAA ratio sitting at 90 percent, in the middle of its one-year range of 85–102 percent. However, we would prefer to allocate now rather than waiting for valuations to reach extremes: the five-year high in this ratio was 251 percent in March 2020, when AAAs yielded 3.4 percent (they now yield 4.4 percent). Further, supply and demand should provide market support from December through early 2024, when principal and interest payments should exceed new issuance.

By Allen Li and Michael Park

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Ratios of AAA Munis to Treasuries Are Within One-Year Wides



Source: Guggenheim Investments, Municipal Market Monitor. Data as of 10.18.2023.

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