WEEKLY MARKET COMMENTARY

THE WEEK IN MUNILAND

NOVEMBER 22, 2021

WHIPLASH

+ Ahead of the Thanksgiving week, interest rates continue to remain volatile as the market digests recent inflation prints and the announcement of new COVID-19 restrictions overseas. For example, 10-year US Treasury yields increased 5 basis points (b.p.) to 1.63% earlier in the week, only to fall to 1.54% by Friday. For the week, 10-year muni yields increased just 1 b.p., resulting in the Bloomberg Municipal Bond Index being flat.

    - **Why it matters:** Munis tend to be less volatile relative to US Treasuries during both up and down weeks. The muni market will generally be more patient, waiting to see if any move in US Treasury yields is sustained. As we move into 2022, muni investors can expect that if US Treasury yields increase, muni yields will move less since munis move on an after-tax spread basis...generally 60% of a US Treasury move. With that said, index returns were mixed for the week. BBB-rated and high-yield indices returned +0.05% and +0.04%, respectively, versus the AAA-rated index, which returned –0.03%.

+ Record 2021 inflows of $95 billion, coupled with an estimated –$46 billion in net tax-exempt municipal supply, have created an extremely supportive technical environment for munis this year. This strong technical environment has been a positive tailwind despite the relatively low-yield environment. Looking forward, we expect market technicals to remain supportive into 1Q of 2022.

    - **Why it matters:** With only a few weeks of trading left in 2021, investors are beginning to look towards what 2022 may bring. While it is hard to imagine municipal flows as robust as what we have seen this year, the supply picture remains supportive. Overall municipal issuance is expected to be net positive in 2022, with net tax-exempt supply expected to be slightly positive.

+ Through September, year-to-date (YTD) tax receipts for the 47 states that report show an average increase of 17.3% compared to 2020. Perhaps more surprising, YTD tax receipts increased 14.4% relative to 2019.

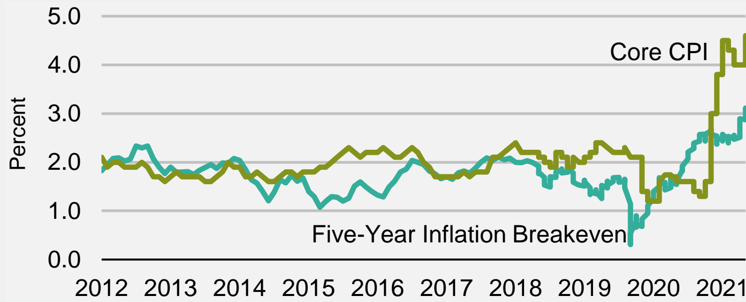
    - **Why it matters:** S&P Global Ratings raised the outlook on the state of Illinois's general obligation (GO) bonds to positive from stable, citing improved finances. Like many states, Illinois has benefited from a bevy of stimulus money and better-than-expected tax collections. However, we remain cognizant that Illinois does face long-term fiscal challenges—particularly related to its pension liabilities. While Illinois is the lowest-rated state, demand for Illinois GO bonds has been extremely strong. Year to date, credit spreads, or the excess income an investor realizes versus a similar maturity AAA bond, have compressed 100 b.p., fueling additional price performance.

Positioning for Today's Market

+ **Inflation Protection:** Inflation largely priced into the market, but protection can have value, given the uncertain environment (*Display 1*).
+ **Interest-Rate Risk:** Target slightly shorter duration versus the appropriate benchmark.
+ **Credit Risk:** Own credit to protect against rising interest rates and inflation (*Display 2*).
+ **Taxable Bonds:** Own US Treasuries, given expensive AAA muni/US Treasury ratios (*Display 3*).

Displays of the Week: November 22, 2021

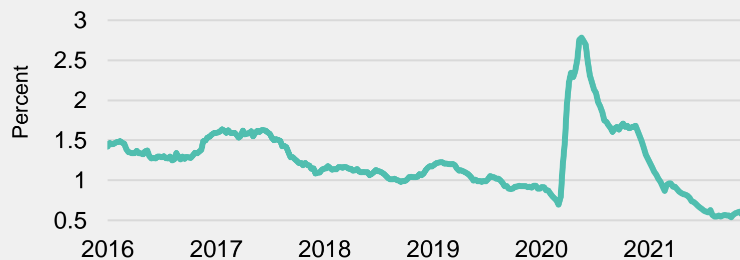
Display 1: Core CPI vs. Five-Year Inflation Breakeven



Break-even inflation rates have increased, as high inflation is expected to be persistent. The market now expects inflation to be 3.02% for the next five years.

Core CPI through October 31, 2021; five-year inflation breakeven through November 19, 2021
Source: Federal Reserve Bank of St. Louis and AllianceBernstein (AB)

Display 2: BBB Municipal Credit Spreads



BBB credit spreads are through pre-COVID-19 levels. However, owning midgrade and high-yield bonds can provide protection against rising interest rates and inflation.

Through November 19, 2021
Source: Bloomberg and AB

Display 3: AAA Muni/US Treasury Ratios

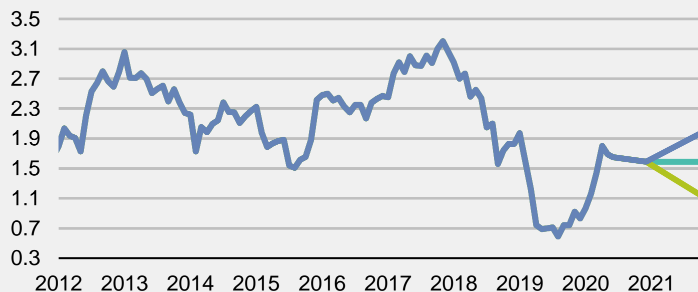
	February 16, 2021	November 19, 2021	5-Yr. Average
2 Year	64%	45%	84%
5 Year	39%	50%	78%
10 Year	55%	74%	90%
15 Year	60%	73%	98%
20 Year	61%	67%	98%
30 Year	65%	78%	98%

Ratios have rebounded from their all-time lows, though they remain below long-term averages.

As of November 19, 2021
Source: Municipal Market Data and AB

Display 4: Expected 12-Month Municipal Returns Scenario Analysis

10-Year US Treasury Yield (Percent)



10-Year Treasury, 2.00% → **0.15%**

10-Year Treasury, 1.54% → **1.45%**

10-Year Treasury, 1.00% → **3.05%**

Past performance and historical analysis do not guarantee future results.
Display reflects expected returns of a 5.4-year-duration intermediate municipal portfolio under three scenarios: 10-year US Treasury yields rise to 2.00%, remain the same or decline to 1.00% over the next 12 months.
Through November 19, 2021
Source: Bloomberg and AB

A Word About Risk

Market Risk: The market values of the Portfolio's holdings rise and fall from day to day, so investments may lose value. **Interest-Rate Risk:** Fixed-income securities may lose value if interest rates rise or fall—long-term securities tend to rise and fall more than short-term securities. The values of mortgage-related and asset-backed securities are particularly sensitive to changes in interest rates due to prepayment risk. **Credit Risk:** A bond's credit rating reflects the issuer's ability to make timely payments of interest or principal—the lower the rating, the higher the risk of default. If the issuer's financial strength deteriorates, the issuer's rating may be lowered, and the bond's value may decline. **Inflation Risk:** Prices for goods and services tend to rise over time, which may erode the purchasing power of investments. **Foreign (Non-US) Risk:** Investing in non-US securities may be more volatile because of the political, regulatory, market and economic uncertainties associated with such securities. These risks are magnified in securities of emerging or developing markets. **Currency Risk:** If a non-US security's trading currency weakens versus the US dollar, its value may be negatively affected when translated back into US-dollar terms. **Diversification Risk:** Portfolios that hold a smaller number of securities may be more volatile than more diversified portfolios, since the gains or losses from each security will have a greater impact on the Portfolio's overall value. **Derivatives Risk:** Investments in derivative instruments such as options, futures, forwards or swaps can be riskier than traditional investments and may be more volatile, especially in a down market. **Leverage Risk:** Trying to enhance investment returns by borrowing money or using other leverage tools magnifies both gains and losses, resulting in greater volatility. **Municipal Market Risk:** Debt securities issued by state or local governments may be subject to special political, legal, economic and market factors that can have a significant effect on the Portfolio's yield or value. An investor cannot invest directly in an index. **Investment and Insurance Products:** Not FDIC insured I Not a bank deposit I Not insured by any federal government agency I No bank guarantee I May lose value

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