WEEKLY
MARKET
COMMENTARY

THE WEEK IN MUNILAND

DECEMBER 6, 2021

PORT IN THE STORM

+ With continued concern surrounding inflation, the emergence of the COVID-19 Omicron variant, and the Fed's timetable regarding tapering and future rate increases, munis rallied during the month of November and into the first week of December. Since November 1, 10-year AAA muni yields are down 19 basis points (b.p.), while US Treasury yields are down 23 b.p.

    - **Why it matters:** Munis are the port in the storm. Strong underlying credit fundamentals coupled with supportive supply and demand technicals have allowed munis to play their role as the bedrock of an overall asset allocation. The Bloomberg Municipal Index returned +0.85% during the month of November, fully offsetting the –0.69% in equity returns measured by the S&P 500. Mid-grade and high yield led the way, although all indices posted positive returns. For the month, BBB-rated and high-yield indices returned +1.09% and +1.31%, respectively, versus the AAA-rated index, which returned +0.83%.

+ The November US labor market report was inconsistent with the "establishment" survey showing a gain of 210,000 jobs and the "household" survey showing a gain of 1.13 million jobs. The establishment survey was quite weak relative to both the past few months and market expectations. In contrast, the household survey was very strong in both absolute and relative terms. The gap between the two surveys is unusually large but not unprecedented, and in this case, it served largely to bring the longer-term averages of the two surveys back in line at around 500,000 per month.

    - **Why it matters:** At that rate, using the employment survey as a barometer, it will be another seven to eight months before the economy reaches a pre-COVID level of employment. That's important because Chair Powell has previously described that benchmark as consistent with "full employment"—which is a prerequisite to the Fed raising rates. Over time, policymakers tend to focus more on the establishment survey as it tends to be less volatile and thus more reliable. Furthermore, given the Omicron variant, Friday's weak establishment report likely tilts the Fed's scale in favor of maintaining the current pace of tapering. However, this plan could change as more health data becomes available. Either way, it is important for muni participants to remain active and flexible to adjust portfolio positioning as market conditions change.

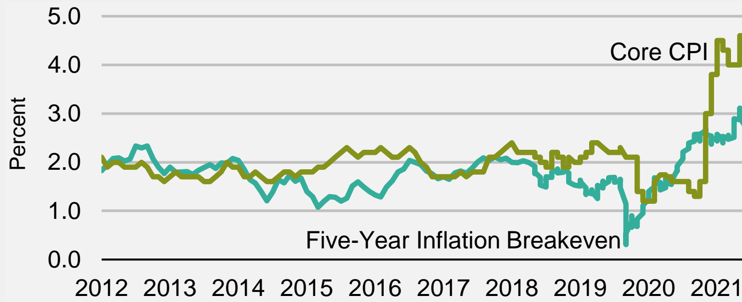
+ With the recent passage of the $1.2 trillion infrastructure bill and the ongoing debate regarding the ~$2 trillion Build Back Better Plan, many have asked the impact, if any, these bills will have on the municipal market. For a more in-depth discussion, please view our special topics piece, Federal Spending and Muni Market Impact Update.

Positioning for Today's Market

+ **Inflation Protection:** Given recent declines in inflation breakevens, a small position in explicit inflation protection is reasonable (*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: December 6, 2021

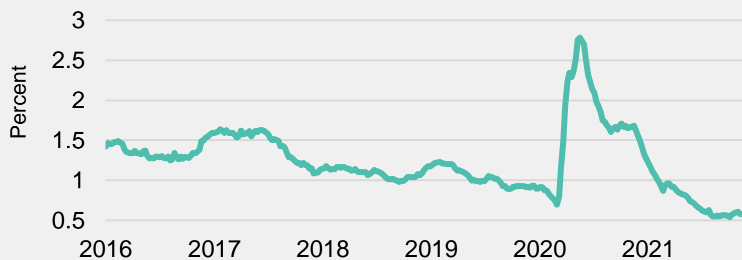
Display 1: Core CPI vs. Five-Year Inflation Breakeven



Break-even inflation rates have increased, as high inflation is expected to be persistent. The market now expects inflation to be 2.72% for the next five years.

Core CPI through October 31, 2021; five-year inflation breakeven through December 3, 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 December 3, 2021
Source: Bloomberg and AB

Display 3: AAA Muni/US Treasury Ratios

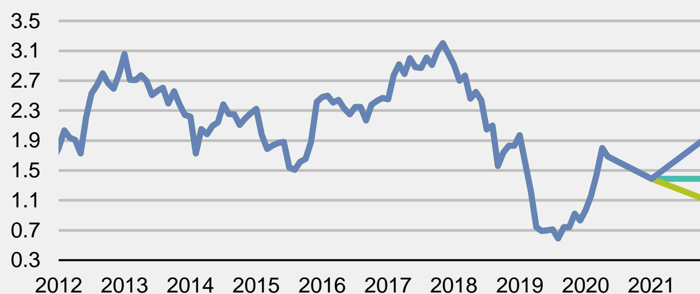
	February 16, 2021	December 3, 2021	5-Yr. Average
2 Year	64%	40%	84%
5 Year	39%	54%	78%
10 Year	55%	77%	90%
15 Year	60%	82%	98%
20 Year	61%	75%	98%
30 Year	65%	88%	98%

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

As of December 3, 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% → **0.10%**

10-Year Treasury, 1.34% → **1.40%**

10-Year Treasury, 1.00% → **2.75%**

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 December 3, 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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