WEEKLY MARKET COMMENTARY

THE WEEK IN MUNILAND

MARCH 14, 2022

THE WAIT IS OVER

+ Municipal yields followed US Treasury yields higher this week as the market gave back some of last week's gains stemming from the Russia/Ukraine conflict. Ten-year Treasury yields rose 28 basis points (b.p.), eclipsing the 2.00% mark for the third time this year—a level where fixed income markets have begun to see support in the past. Ten-year municipal yields rose 23 b.p., and the Bloomberg Municipal Index returned –1.13% for the week, outperforming the Bloomberg High Yield Municipal Index, which returned –1.31%.

    - **Why it matters:** While the municipal market is experiencing volatility, it has not followed some of the extreme swings in the US Treasury market. The Treasury market is contending with a multitude of factors such as geopolitical concerns, inflation and rising rates. Municipals, on the other hand, have had their eye on the upcoming Fed meeting next week for some time. Municipals continue to look attractive on a relative basis versus treasuries, and while there may be additional short-term volatility, we believe that today is an attractive entry point for long-term investors. Intermediate municipal bonds are generating close to double the amount of income today than where they started the year.

+ US CPI for February was consistent with expectations for headline and core inflation, coming in at 7.9% and 6.4% year over year, respectively. While not unexpected, this is the highest print in 40 years.

    - **Why it matters:** Unfortunately, the February print reflects a period prior to Russia's invasion of Ukraine, so these figures are likely to remain high in the short term. With that said, we do not believe that there are any near-term policy ramifications from these CPI prints and expect the Fed to raise 25 b.p. following their meeting this week. Persistently high inflation, combined with the fact that energy prices will push inflation even higher, suggest that all options are on the table going forward for the Federal Reserve.

+ While the first rate hike marks the beginning of a tightening cycle, it is important to look further out than just next week when proactively positioning portfolios.

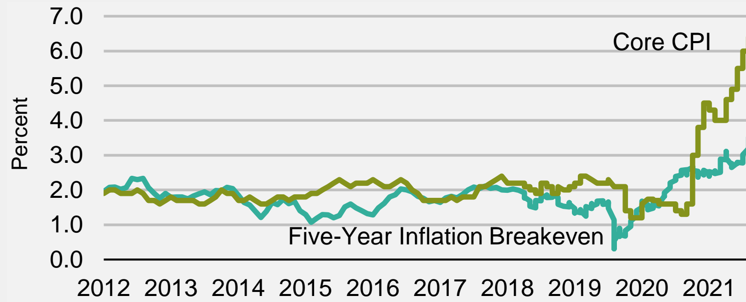
    - **Why it matters:** The market is pricing in six rate hikes this year. While that is certainly noteworthy, we remind investors that much of this is already priced into the intermediate and long end of the yield curve. That is important because we would not expect a parallel shift in the yield curve as the Fed raises short-term rates—the Fed raising rates 100 b.p. does not equal a 100 b.p. rise in the 10-year US Treasury yield. Much of the pain has already been felt for long-term fixed income investors, but the need to be active as markets fluctuate is crucial going forward.

Positioning for Today's Market

+ **Inflation Protection:** Given current level of inflation breakevens, reduce inflation protection exposure (*Display 1*).
+ **Interest-Rate Risk:** As yields have increased, target neutral duration versus the appropriate benchmark.
+ **Credit Risk:** Own credit to protect against rising interest rates and inflation (*Display 2*).
+ **Taxable Bonds:** Eliminate US Treasury position given that munis have become fair value (*Display 3*).

Displays of the Week: March 14, 2022

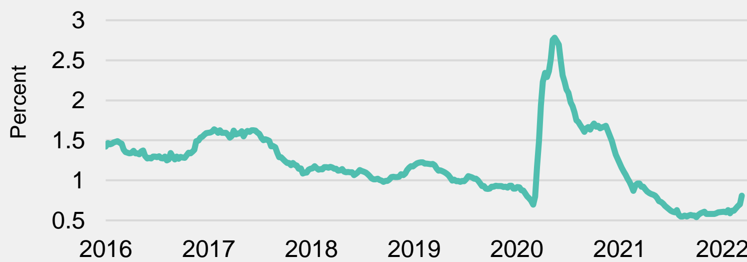
Display 1: Core CPI vs. Five-Year Inflation Breakeven



Break-even inflation at 3.52% indicates that the market expects core CPI to drift lower over time.

Core CPI through February 28, 2022; five-year inflation breakeven through March 11, 2022
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 March 11, 2022
Source: Bloomberg and AB

Display 3: AAA Muni/US Treasury Ratios

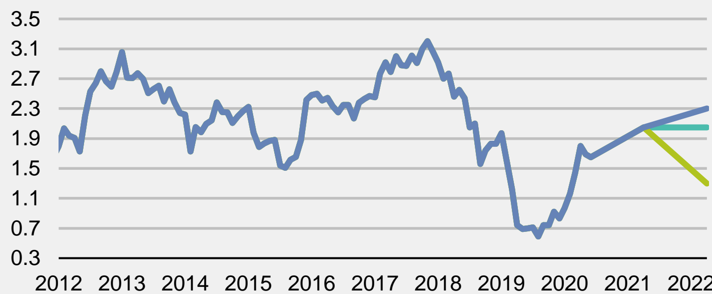
	January 5, 2022	March 11, 2022	5-Yr. Average
2-Year	36%	72%	83%
5-Year	44%	79%	77%
10-Year	64%	92%	89%
15-Year	65%	99%	97%
20-Year	64%	86%	97%
30-Year	73%	96%	97%

Ratios have rebounded from their all-time lows and are now cheap-to-fair value.

As of March 11, 2022
Source: Municipal Market Data and AB

Display 4: Expected 12-Month Municipal Returns Scenario Analysis

10-Year US Treasury Yield (Percent)



10-Year Treasury, 2.25% → **1.90%**

10-Year Treasury, 2.00% → **2.65%**

10-Year Treasury, 1.25% → **4.90%**

Past performance and historical analysis do not guarantee future results.
Display reflects expected returns of a five-year duration intermediate municipal portfolio under three scenarios: 10-year US Treasury yields rise to 2.25%, remain the same or decline to 1.25% over the next 12 months.
Through March 11, 2022
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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