The Week in Muniland

April 22, 2024

Death, Taxes and the Summer Technical

Muni yields were higher for the week, with two-, 10- and 30-year AAA municipal yields up 4, 7 and 7 basis points (bps), respectively, while two-, 10- and 30-year US Treasury (UST) yields rose 8, 9 and 8 bps, respectively. For the week, the Bloomberg Municipal Bond Index (Index) returned –0.30% and is down –1.02% month to date and –1.40 year to date.

- **Why it matters:** One explanation for this week's move higher in yields is that stronger-than-expected economic data are forcing the Fed to adopt a more patient approach to reducing rates. The front end of the yield curve has already repriced, which means that rate volatility gets pushed further out along the yield curve, making the moves in rates more of a term-premium story. Investors were clearly spooked by the move higher in yields, as muni mutual funds reported $1.5 billion in net outflows this week. This outflow is not surprising, as retail investors tend to follow performance. Year to date, mutual fund net flows remain positive at $10.4 billion. Investors should be taking advantage of this back-up in yields, not running away from it.

Every year like clockwork, the summer months provide significant technical support to the municipal market. It's never a question of if, but of just how much, support it will provide.

- **Why it matters:** During the summer months, the typical lack of new issue supply is met with an increase in reinvestment income that comes from bond coupon payments and maturities. This year, the anticipated $100 billion of new issue supply during June–August is expected to be met with $117 billion of reinvestment income. This creates an environment where there is more cash available than bonds to buy, which tends to bode well for performance. Since 1991, the average return of the Index in May, June, July and August has been 0.76%, 0.31%, 0.80% and 0.65%, respectively. There have been instances, however, when the summer technical has not entirely offset broader macro events. Nevertheless, the summer technical is real and investors should understand its influence as we near the beginning of summer. For those sitting in cash or rolling T-bills, now may be an opportune time to consider reentering the muni market to take advantage of this upcoming positive seasonality and high starting yields.

While investors are understandably anxious for a significant rebound in bond prices, investors should have no problem "clipping" the current higher yields for longer.

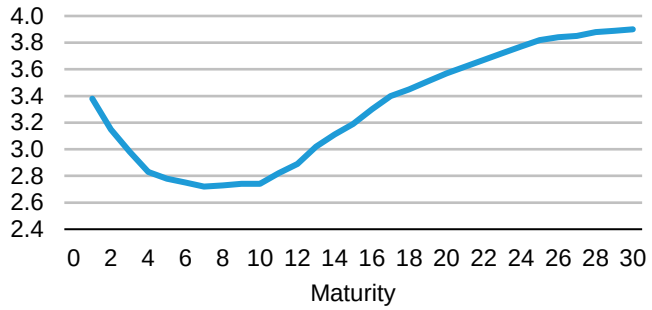
- **Why it matters:** At the beginning of this year, the market was expecting six cuts by the Fed for a total of approximately 150 bps. Today, the market is pricing in 42 bps of cuts. Investors are now concerned that interest rates will stay higher for longer. Why should that be of concern? Investors should welcome higher yields and understand that the engine of a bond is its income. Today, muni bonds have a sizable engine. The yield of the Index is 3.70%, which is nearly four times what it was in January 2021, when it was 0.95%. From a price perspective, the average bond price in the Index today is $101, compared to $115 in January 2021. Over the past 10 years, the lowest average bond price of the Index was $95.5 in October 2023, right before the muni market rallied 6.35% in November. Credit is also attractive, as the Bloomberg BBB muni index has an average bond price of $95! In comparison, the average price in April 2021 was $111. The lowest price for this Index over the past decade was also in October 2023, when it was $87.6. The anticipation is that we will not get back to those low dollar prices, so investors have to ask themselves, what am I playing for? Perhaps the average dollar price will drop a little more, but in 12 to 24 months, with yield likely lower, investors will be happy they invested today.

Positioning for Today's Market

- **Interest-Rate Risk:** Target long duration versus the appropriate benchmark.
- **Maturity Structure:** Target a barbell maturity structure to capitalize on high front-end and long-end yields.
- **Credit Risk:** Own municipal credit. Spreads are wide, and fundamentals remain strong.
- **Taxable Bonds:** Own US Treasuries, as municipals have become expensive (*Display 3*).

Displays of the Week: April 22, 2024

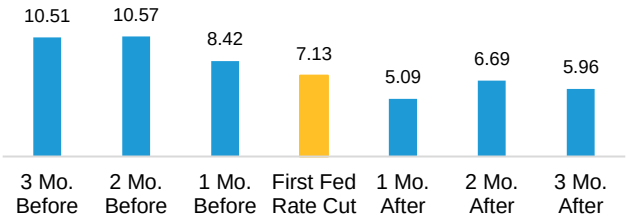
Display 1: AAA-Rated Municipal Yields (Percent)



As of April 19, 2024
Source: Municipal Market Data and AB

The municipal yield curve is inverted. A barbell maturity structure remains most advantageous.

Display 2: Average 12-Month Forward Return Around the Start of an Easing Cycle (Percent)



Current analysis and forecasts do not guarantee future results. Display based on the following dates of first rate cuts: September 20, 1984; June 7, 1989; July 6, 1995; January 3, 2001; September 18, 2007; August 1, 2019.
As of December 31, 2023
Source: Bloomberg, US Federal Reserve and AB

Higher yields and the potential start of a Fed easing cycle should lead to a strong year for municipal fixed income.

Display 3: Municipal and Treasury After-Tax Spreads (Basis Points)

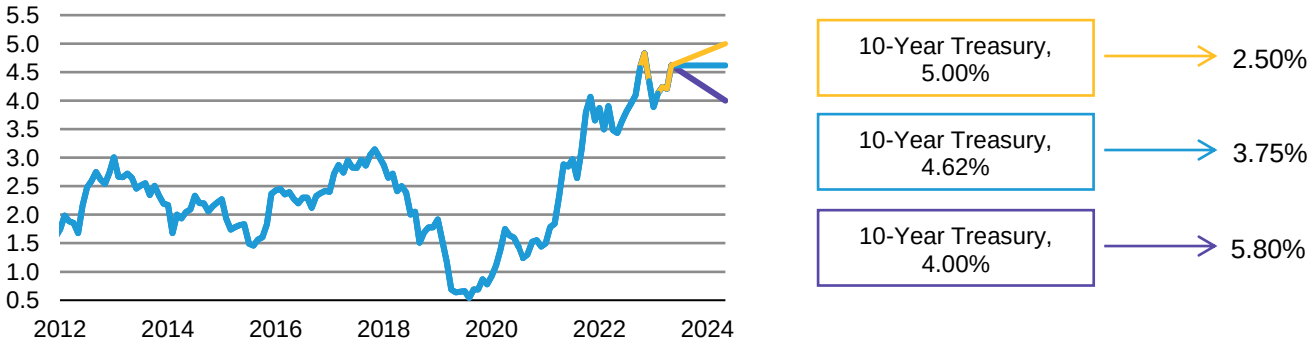
	Dec 31, 2023	Apr 12, 2024	Five-Year Average
Two-Year	–13	21	15
Five-Year	–15	–2	21
10-Year	–10	0	46
15-Year	39	39	71
20-Year	54	70	78
30-Year	94	111	93

As of April 19, 2024
Source: Bloomberg and AB

Shorter-maturity munis have recently cheapened relative to US Treasuries, although they are still relatively expensive versus US Treasuries for maturities of 5 to 15 years.

Display 4: Expected 12-Month Municipal Returns Scenario Analysis

10-Year US Treasury Yield (Percent)



Past performance and historical analysis do not guarantee future results.
Display reflects expected returns of the Bloomberg Municipal Bond Index under three scenarios: 10-year US Treasury yields rise to 5.00%, remain the same or decline to 4.00% over the next 12 months.
As of April 19, 2024
Source: Bloomberg and AB

The views expressed herein do not constitute research, investment advice or trade recommendations and do not necessarily represent the views of all AB portfolio-management teams. Views are subject to change over time.

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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