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Municipal Market Insights

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Special Addition: The Election Impact

4Q2024 Outlook: For the remainder of 2024, we believe there is the potential for positive total returns for municipals; albeit with the potential for some volatility too. October looks to offer more new issue supply than reinvestment dollars from coupons and maturities, which could put some pressure on municipal performance in the near term – especially as issuers continue to look to issue bonds in advance of the US elections. Following the election we expect a drop off in supply and likely a year-end rally as fund flows and reinvestment dollars chase comparatively fewer new issue opportunities. More generally, the outcome of the November election could have a dramatic impact on projected U.S. budget deficits, future U.S. Treasury bond supply, and tax policies. Of particular focus in the new year is the expiration of the Tax Cuts and Jobs Act (TCJA), the expiration, continuation or alteration of which could have various impacts on municipal demand in 2025 and beyond.

For clients seeking less volatility, the 1-5 year portion of the municipal yield curve continues to provide attractive income per unit of duration, in our view. However, we find the 12-21 years to maturity portion of the municipal yield curve particularly attractive. By year end, we expect longer duration strategies with a high yield (HY) component to produce the highest total returns.

Credit Spreads and Sectors: While nominal municipal bond yields and taxable equivalent yields remain attractive in our view, credit spreads are relatively tight all along the credit rating spectrum. We continue to see value in purchasing airports, gas bonds, hospitals, and select senior living facilities.

Election 2024 | Harris Tax Plan vs. Trump Tax Plan

The table below outlines the tax policies proposed by the presidential candidates, along with our viewpoint on the potential impact.

	Trump		Harris	
	Proposal	**Potential Impact**	**Proposal**	**Potential Impact**
Personal Income Tax Rates	Make current tax rates (37%) permanent	Neutral	Maintain rates on those making less than $400k. Raise the top tax rate from 37% to 39.6%	Increased demand for municipal bonds
Corporate Income Tax Rates	Reduce rate from 21% to 15% for companies that make products in the U.S.; reduce rate to 20% otherwise.	Reduced demand from banks and insurers	Increase rate from 21% to 28%	Increased demand from banks and insurers
State and Local Tax (SALT) Deductions	Reinstate an unlimited itemized deduction for state and local taxes paid or discontinue the cap as part of TCJA extension.	Neutral to moderately negative. An allowance for greater deductions of state and local taxes could marginally reduce the demand for municipal bonds.	No clear proposal	Unclear
Alternative Minimum Tax (AMT)	Make current TCJA exemptions permanent	Neutral	No clear proposal	Unclear
Long Term Capital Gains	No clear proposal	Neutral	Increase the top tax rate on long-term capital gains to 28% for taxable income above $1 million.	Mixed. A higher capital gains rate could make the muni tax exemption more attractive, but could also reduce municipal trading activity.

Sources: Bank of America; Tax Foundation; Tax Policy Center

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YTD 2024 Municipal Market Review

Hearty Municipal New Issue Supply: Through the end of 3Q 2024, year-to-date (YTD) municipal primary supply increased approximately 36.2% year-over-year (YOY) to $374 billion. The increase in primary market supply was due to a number of factors including greater refinance activity including Build America Bonds, and the likely result of borrowers determined to issue debt before U.S. elections.

Positive Municipal Fund Flows: According to data provided by the Investment Company Institute, YTD through September 30, 2024, municipal fund inflows totaled a robust $29 billion. This marks a healthy increase over the $1.9 billion of inflows for the same time period in 2023.

Healthy Municipal Credit Trends: According to data provided by Municipal Market Advisors (MMA), YTD defaults as of September 4, 2024 totaled 37 municipal borrowers and approximately $2.04 billion in par value compared with 41 defaults and $2.35 billion in par value for the same period a year ago.

Municipal Ratios and Credit Spreads: Over the course of the third quarter, municipal-Treasury yield ratios had moved toward fair value. Credit spreads have tightened slightly for AA and BBB bonds but widened slightly for A and HY/non-rated bonds.

Municipal Market Total Returns and Spreads

YTD Performance/Total Return: Using the Bloomberg Municipal Bond Total Return Index and Bloomberg Muni High Yield Total Return Index, YTD through the 3Q of 2024, these two indexes generated total returns of +2.30% and +7.48%, respectively.

By credit rating category, according to BofA Global Research, lower rated credits outperformed higher rated bonds. For the 3Q through September 25, 2024, AAA, AA, A, BBB and HY munis had the following total returns: 1.85%, 2.10%, 3.09%, 4.42%, and 8.0%, respectively.^

Using 3Q data provided by Bloomberg, credit spreads have tightened in modestly over the years. AA spreads are 1bp, A are 38bps, BBB are 90 bps and HY are 202bps. AA, A, BBB and HY bonds tightened by 5 bps, 20 bps, 33 bps and 56 bps, respectively.

4Q 2024 Outlook

Economy: With solid payroll gains and low initial unemployment and continuing claims, no recession appears in the near-term horizon. However, lower income U.S. consumers appear to be finally reacting to the affects of inflation and savings draw-downs with consumption moderating. The impacts of various geopolitical events (escalating tensions in the middle east) and acts of God (Hurricanes Helene and Milton) are not easy to quantify or predict how they might influence inflation, the economy and interest rates.

Inflation: After discouraging Consumer Price Index (CPI) and Personal Consumption Expenditures Price Index (PCE) inflation data persisted throughout the first quarter of 2024, the past few months of data have brought some relief and a continued gradual decline in inflation is forecast.

Federal Reserve & Rates: The Federal Reserve (Fed) has clearly signaled they are balancing the risks of reignition of inflation against the risk to the labor market, as evidenced by the 50-basis point cut announced at their September meeting. We expect an additional two 25-bp cuts for the remainder of the year and for the U.S. 10-year Treasury Note (UST) to be range bound in the 3.50-4% range over the next few months.

Municipal Fund Flows: Assuming we are correct that the Fed continues cutting interest rates in the fourth quarter of 2024 and U.S. Treasury rates become rangebound, we expect fund flows to remain consistently positive.

Municipal New Issue Supply: Full year gross municipal bond new issue supply is forecast at approximately $450 to $475 billion.

Credit Quality: We expect municipal bond credit quality to remain broadly stable. Looking at data from Moody's through the first half of 2024, upgrades outpaced downgrades by a ratio of 2.11.

Past performance is no guarantee of future results.

^A credit rating is an assessment provided by a one or more nationally recognized statistical rating organizations (NRSROs), including S&P Global Ratings, Moody's Investors Service, Inc., Fitch Ratings, DBRS, Inc., Kroll Bond Rating Agency, Inc. or a comparably rated NRSRO, of the creditworthiness of an issuer with respect to debt obligations. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest). Investment grade is defined as those issuers that have a long-term credit rating of BBB-or higher. Credit ratings are subject to change. AAA munis are represented by the Bloomberg Municipal AAA Index Total return Index Value Unhedged USD. AA munis are represented by the Bloomberg Municipal AA Index Total return Index Value Unhedged USD. A munis are represented by the Bloomberg Municipal A Index Total return Index Value Unhedged USD. BBB munis are represented by the Bloomberg Municipal BAA Index Total Return Index Value Unhedged USD. HY munis are represented by the Bloomberg Muni High Yield Total Return Index Value Unhedged USD.