JUNE 2024

# Municipal Market Insights

**Johnathan N. Wilhelm, JD**
Senior Vice President
Senior Portfolio Manager

**Tom Byron**
Senior Vice President
Senior Portfolio Manager

**Shawn P. O'Leary**
Senior Vice President
Senior Portfolio Manager

**Nick Novosad, CFA**
Senior Vice President
Client Portfolio Manager

## 1H 2024 Municipal Market Review

**Hearty Municipal New Issue Supply:** Through June 26, 2024, year-to-date (YTD) municipal primary supply increased approximately 37% to $235 billion, according to BofA Global Research Municipals Weekly. 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 LSEG Lipper and J.P. Morgan, YTD through June 27, 2024, municipal fund inflows totaled a robust $11.43 billion. Of this total, high yield (HY) municipal (muni) funds have received approximately $7.44 billion.

**Healthy Municipal Credit Trends:** According to data provided by Municipal Market Advisors (MMA), YTD defaults as of June 26, 2024 totaled 25 municipal borrowers and approximately $1.43 billion in par value compared with 28 defaults and $1.67 billion in par value for the same period a year ago.

**Municipal Ratios and Credit Spreads:** At quarter end, municipal-Treasury yield ratios had moved towards neutral in both the short and long end of the municipal yield curve. Regarding credit spreads, utilizing data from Bloomberg, credit spreads have tightened across credit rating categories including AA, A, BBB, and HY/non-rated.

## Municipal Market Total Returns and Spreads

**1H 2024 Performance/Total Return:** Using the Bloomberg Municipal Bond Total Return Index and Bloomberg Muni High Yield Total Return Index, during the first half of 2024, these two indexes generated total returns of -0.40% and +4.14%, respectively.

By credit rating category, according to BofA Global Research, lower rated credits outperformed higher rated bonds. Year-to-date through June 26, 2024, AAA, AA, A, BBB and HY munis had the following total returns: -0.68%, -0.39%, 0.49%, 1.56%, and 4.60%, respectively.^

Using YTD through June 30, 2024 data provided by Bloomberg, AA, A, BBB, and HY spreads have tightened by 4 basis points (bps), 21 bps, 44 bps, and 74 bps, respectively. While credit spreads are relatively low, nominal yields and taxable equivalent yields are attractive and have room to tighten a bit further.

## 2H 2024 Outlook

During the second half of 2024, we believe there is the potential for positive total returns for both short and longer duration strategies. For investors seeking less volatility, we believe the 1-5 year portion of the municipal yield curve may continue to provide attractive income per unit of duration. However, in our view, the 12-21 years to maturity portion of the municipal yield curve is particularly attractive. We expect volatility of returns in October-November as the election result may have a dramatic impact on projected U.S. budget deficits, future U.S. Treasury bond supply, and tax policies. By year end, we expect longer duration strategies with a HY component may have the potential to produce attractive 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.

**Economy:** Given healthy payroll gains and low initial unemployment and continuing claims, we believe that no recession appears on the near-term horizon. However, lower income U.S. consumers appear to be feeling the effects of inflation, relatively high interest rates and moderating wage gains. Credit card and auto loan delinquency rates have risen.

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

**Federal Reserve & Rates:** We believe the Federal Reserve (Fed) is done hiking rates in this interest rate cycle. We expect the U.S. 10-year Treasury Note (UST) to be within the 4.0%-4.5% range over the next several months.

**Municipal Fund Flows:** Assuming we are correct that the U.S. Treasury rates become range bound, 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, according to BofA Global Research Municipals Weekly.

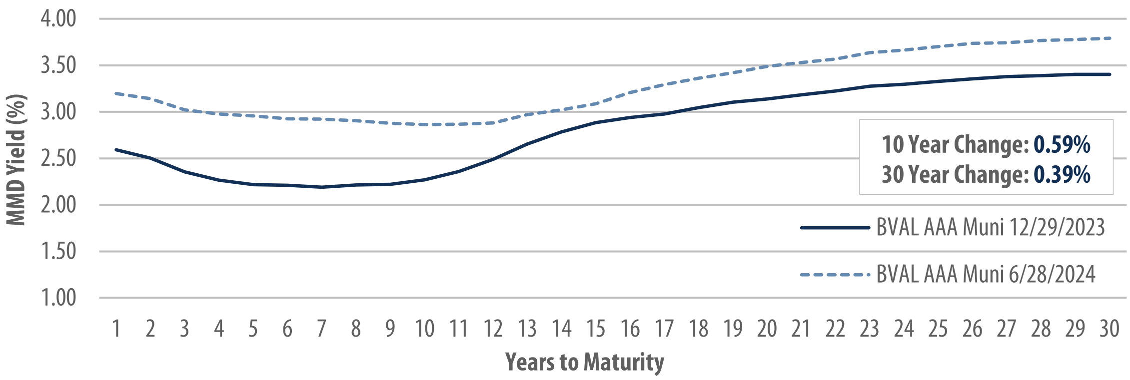
**Credit Quality:** We expect municipal bond credit quality to remain broadly stable. Through the first half of 2024, looking at data from S&P, Moody's, and Fitch, Bloomberg and J.P. Morgan calculated that there was an upgrade to downgrade ratio of approximately 2.1x which represents a deceleration from 2023's more positive ratios. Weaker sectors include heath care and higher education.

***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.

# Municipal Market Insights | JUNE 2024

## Municipal AAA Curve Comparison 12/29/2023 vs. 6/28/2024

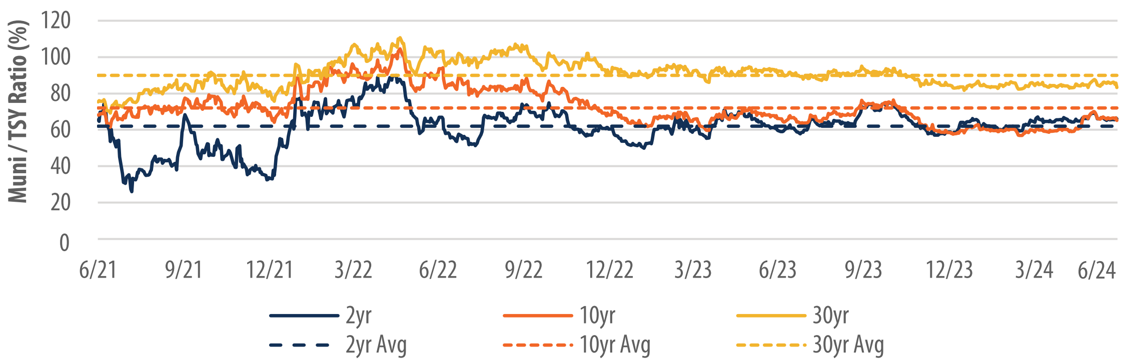



Source: Bloomberg. Data as of 6/30/2024. **BVAL AAA** represents the AAA rated bonds in the Bloomberg High Yield Total Return Index Value Unhedged USD which covers the USD denominated long-term tax-exempt bond market. **Past performance is not a guarantee of future results.**

YTD through 6/30/24, BVAL AAA yields are approximately 60-70 bps higher in the 1 to 9-year part of the municipal curve and 30+ bps higher in the 17 to 30-year part of the municipal curve.

The "AAA" municipal yield curve is currently inverted from 2-14 years.

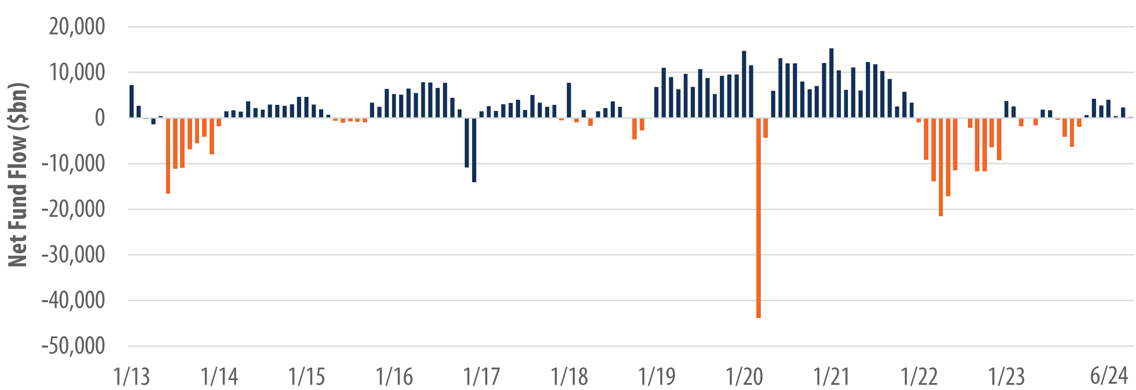
## Municipal Treasury Ratios are Low | Municipal Treasury Ratios




Source: Bloomberg. Data from 6/30/2021 – 6/30/2024. **Treasury** (TSY). **Municipals** are represented by the Bloomberg Municipal Bond Index which tracks the performance of the tax-exempt bond market. The Municipal/Treasury ratio is a percentage of municipal yields against equivalent Treasury yields.

Muni treasury ratios are low compared to their historical averages. The 3-year average for 2-year, 10-year and 30-year Municipal Treasury ratios is 62%, 72%, and 90%, respectively.

## Municipal Fund Flows Turn Positive | Net Municipal Fund Flows

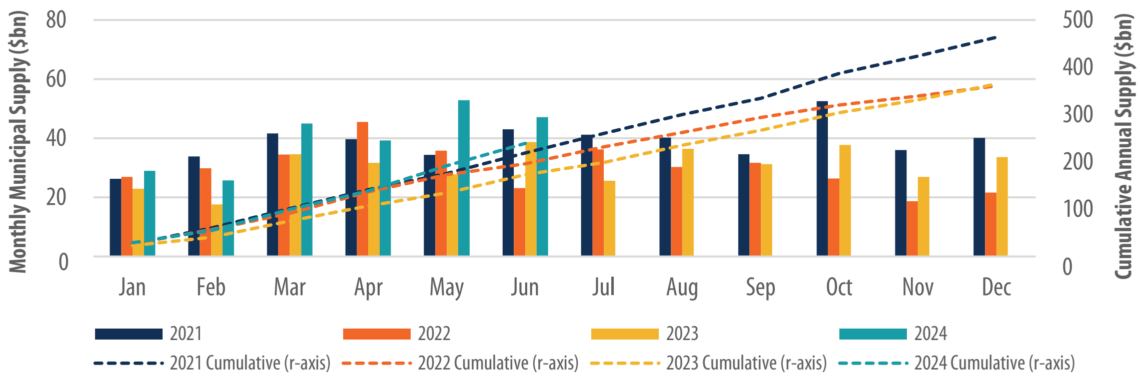



Source: Bloomberg and Investment Company Institute. Data from 1/31/2013 – 6/28/2024. **Municipal Fund Flows** are represented by the US ETF Flows – Municipals Index which measures the fund flows in USD millions of US listed ETFs in the Fixed Income Municipals Category. Data compiled by Bloomberg and subject to revision

After two years of Exchange-Traded Fund (ETF) outflows in 2022-2023, ETF fund flows turned positive year-to-date. Through June 28, 2024, total municipal ETF inflows were $13.944bn versus the same period in 2023 of $4.659bn.

# Municipal Market Insights | JUNE 2024

## Municipal New Issue Supply




2021 new issuance supply was $464bn.

2022 new issuance supply totaled $361bn which was $103bn lower year-over-year.

2023 new issuance supply total was $365bn which was $4bn above 2022. However, that was nearly $100bn below 2021.

YTD (through June 28, 2024) new issue supply stands at $239.1bn, up 37.9% year-over-year. Issuance is largely comprised of new money as opposed to refunding, which is to be expected in a higher rate environment.

Source: Securities Industry and Financial Markets Association (SIFMA). **Municipal New Issue Supply** is represented by the Bloomberg Municipal YTD Issuance Total Index which is based on Bloomberg Fixed Rate Municipal Calendars. Excludes accreted value of capital appreciation bonds and short-term notes.

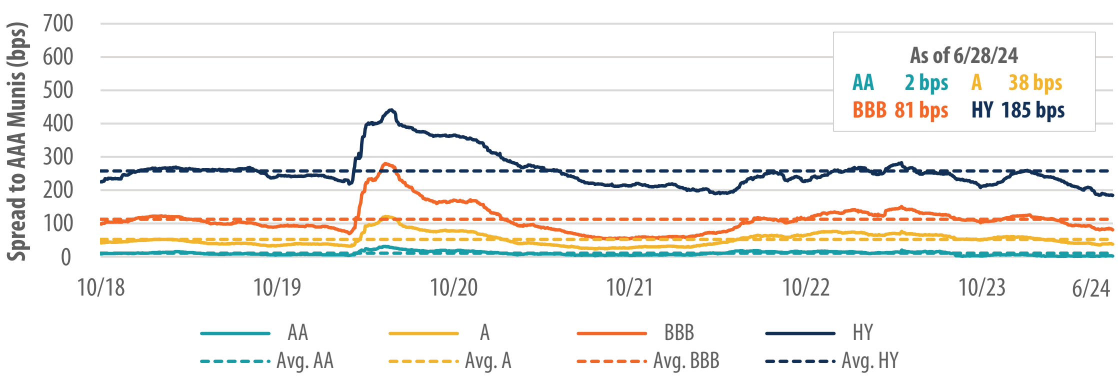
## Current Default Rates Remain Low | Monthly First Time Municipal Defaulters

| Year | 2024 | | 2023 | | 2022 | | 2021 | | 2020 | |
|---|---|---|---|---|---|---|---|---|---|---|
| Month/Quarter | Number | $Billion | Number | $Billion | Number | $Billion | Number | $Billion | Number | $Billion |
| 1Q Total | 9 | 0.6 | 9 | 0.7 | 15 | 1.0 | 19 | 1.1 | 11 | 2.8 |
| Apr | 5 | 0.4 | 2 | 0.2 | 4 | 0.3 | 4 | 0.1 | 4 | 0.1 |
| May | 6 | 0.3 | 5 | 0.1 | 3 | 0.3 | 2 | 0.1 | 10 | 0.4 |
| Jun | 3 | 0.2 | 9 | 0.4 | 3 | 0.2 | 5 | 0.2 | 11 | 0.6 |
| 3Q Total | | | 12 | 0.6 | 12 | 1.3 | 16 | 1.0 | 24 | 1.3 |
| 4Q Total | | | 1 | 0.0 | 21 | 0.6 | 17 | 0.4 | 23 | 0.6 |
| Year-to-date | 23 | 1.40 | 25 | 1.46 | 25 | 1.76 | 30 | 1.56 | 36 | 3.90 |
| Total | 23 | 1.40 | 38 | 2.06 | 58 | 3.92 | 63 | 2.90 | 83 | 5.85 |

YTD (through June 2024), current default rates total $1.40 billion. This muted level is in line with default rates since the most recent recession in 2020.

Source: Municipal Market Advisors (MMA) data as of June 2024, most recent data available. Numbers may not foot due to rounding.

## Spreads Across Credit Rating Categories Have Tightened YTD | Municipal Credit Spreads




Spreads are tighter YTD. Using YTD data through June 30th, 2024, provided by Bloomberg, AA, A, BBB, and HY spreads have tightened by 4 bps, 22 bps, 44 bps, and 74 bps, respectively. A dearth of HY new issue supply coupled with HY fund inflows is pushing spreads tighter.

Source: Bloomberg. Data from 12/31/2018 through 6/28/2024. **Municipal Credit Yields** are represented by the Bloomberg Municipal High Yield Total Return Index which is a flagship measure of the non-investment grade and non-rated USD-denominated tax exempt bond market. The chart above is for illustrative purposes only. See ratings descriptions on previous page. **Past Performance is not a guarantee of future results.**