JANUARY 2025

Municipal Market Insights

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2024 Municipal Market In Review

Record Municipal New Issue Supply: According to data from Bloomberg Finance L.P. and JP Morgan, full year 2024 gross issuance totaled $504 billion ($463 billion tax-exempt and $40 billion taxable), just above the prior record of $503 billion in 2020 and up 37% vs. 2023. The increase in primary market supply was due to a number of factors including refinance activity including Build America Bonds, availability of federal funds to help finance infrastructure projects, and the ongoing need to repair and expand our Nation's basic infrastructure.

Municipal Fund Flows: 2024 inflows are positive +$42 billion (+$26.2 billion open-end mutual funds and +$15.8 billion exchange-traded funds). While fund flows were distinctly positive for all of 2024, the final three weeks of December realized weekly fund outflows after municipal rates increased and prices declined in response to higher U.S. Treasury rates. For 2024, fund inflows by rating were +$26 billion investment grade (IG) and +$15.9 billion high yield (HY).

Generally Stable Municipal Credit Trends: According to data provided by Municipal Market Advisors (MMA), as of December 31, 2024, year-to-date (YTD) defaults totaled 62 compared with 2023 and 2022 defaults totaling 57 and 61, respectively. The par value of 2024 defaults at $4.27 billion also exceeded 2023 and 2022 totals. According to data compiled by BofA Global Research, through the first three quarters of 2024, Moody's and S&P upgraded slightly more than 1,000 ratings and downgraded nearly 500, for a combined upgrade to downgrade ratio of 2.2 to 1.0.

Municipal Market Total Returns and Spreads

YTD Performance/Total Return: For 2024, the Bloomberg Municipal Bond Total Return Index and Bloomberg Muni High Yield Total Return Index generated total returns of 1.05% and 6.32%, respectively. Total returns were significantly impacted by December's negative returns, with the Bloomberg Municipal Bond Total Return Index posting a negative total return of -1.46% in December, while the Bloomberg Muni High Yield Total Return Index experienced a negative return of -1.66% for the month.

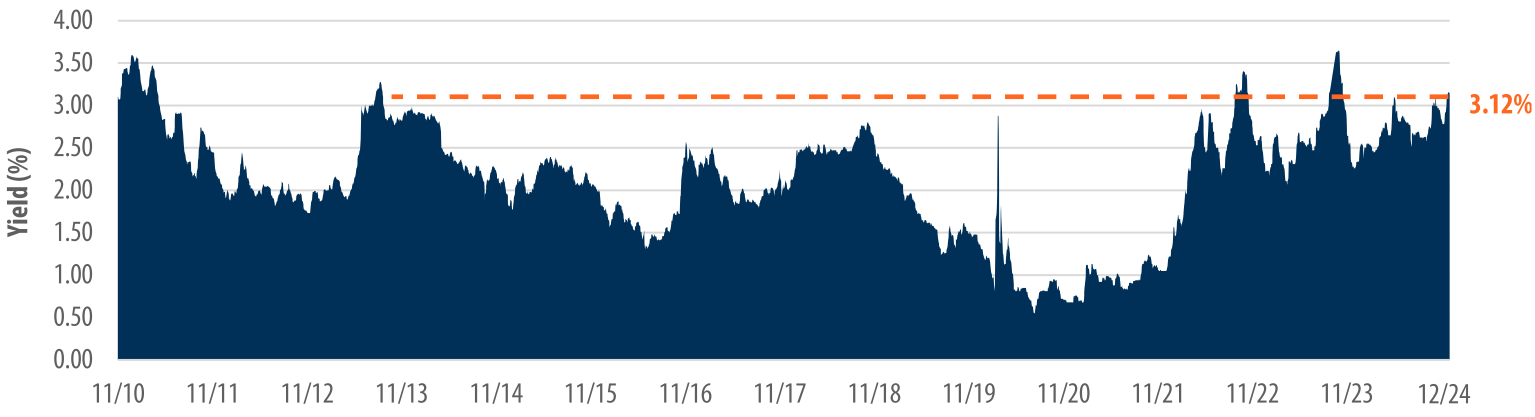
By credit rating category, according to Bloomberg Finance LP and JP Morgan for 2024, total returns for AAA, AA, A, and BBB rated municipals were 0.33%, 0.79%, 1.78%, and 2.87%, respectively.^

During 2024, using full year data provided by Bloomberg, credit spreads tightened across rating categories. From 12/29/2023 to 12/31/2024, credit spreads for AA, A, BBB, and HY spreads tightened by 5, 20, 36 and 67 basis points, respectively. Credit spreads are relatively tight but nominal yields and taxable equivalent yields are attractive for high income earners, in our opinion.

Today's Income Levels are Historically High

Current yield levels are creating income opportunities that haven't been this attractive in over a decade.

3.12% 10 Yr AAA Yield = Taxable Equivalent Yield (TEY) 5.27%



Source: Bloomberg. The chart above is for illustrative purposes only. Past performance is not a guarantee of future results. 049M10Y Index = BFV Muni GO AAA 10 Year Index. The chart shows the municipal bond yields on a TEY (taxable equivalent yield) basis which adjusts the returns using the total federal income tax rate for top income levels (37%) and another 3.8% for the Medicare tax for 2024. State and local taxes have not been considered. This information is based on law as of the date of calculation and does not account for any proposed changes in tax rates. This information does not account for limitations on deductions, the alternative minimum tax or taxes other than Federal personal income tax. It is important to note that there are differences between the investment objectives and risks of municipal bonds versus the asset classes shown above.

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1Q and 2025 Outlook

Economy: With steady but slowing payroll gains, low initial unemployment and continuing claims, no recession appears on the near-term horizon; however, lower income U.S. consumers appear to be reacting to the effects of inflation and savings draw-downs with consumption moderating. Looking ahead, we believe the combined effects of policy change around the Tax Cuts and Jobs Act (TCJA) extension, tariffs, immigration policy and the projected U.S. budget deficit will assuredly influence the economy's strength in 2025.

Inflation: The final months of 2024 showed little progress in taming core inflation, with the core Consumer Price Index (CPI) showing four straight months of +0.3% monthly increases and 12-month core inflation at 3.3%. We do expect gradual improvement in core inflation during 1Q2025.

Federal Reserve & Rates: As expected, the Federal Reserve (Fed) cut the Federal Funds Rate by 25 basis points (bps) in December. Furthermore, the Fed's "dot plot" is showing an additional 2 cuts of 25 bps in 2025, which is down from 4 cuts expected back in September 2024.

Municipal Fund Flows: We expect municipal fund flows will be largely positive during the 1Q of 2025; however, inflation, the projected U.S. budget deficit, and tax policy changes will be critical to the future direction of Treasury rates which is the key factor influencing municipal bond rates.

Municipal New Issue Supply: Our municipal team's 2025 gross municipal bond new issue supply is forecast to be approximately $475 billion-$525 billion, with tax exempt supply estimated at $450 billion.

Credit Quality: We expect municipal bond credit quality to remain broadly stable, with municipal bond defaults relatively unchanged from the past three years. We expect that credit rating upgrade to downgrade ratios will remain positive but less so than experienced in 2023-2024.

Municipal Ratios, Credit Spreads and Total Return Outlook

2025 Total Returns: We believe there is the potential for positive total returns for municipal bonds in 2025, given recent changes in interest rates. Following a rise in municipal rates in December, with 10-year and 30-year AAA municipal yields increasing by 28 basis points to 3.06% and 3.90%, respectively, we view the municipal bond market as attractive from both a nominal and taxable-equivalent yield perspective. Whether interest rates rise or fall in 2025, the return profile of the index is expected to generate positive returns.

Yield Curve, Credit Ratings and Sectors: For clients seeking less volatility, the 1-6 year portion of the municipal yield curve continues to provide attractive income per unit of duration. For total return oriented investors, by year end 2025, we believe longer duration strategies with a HY component have the potential to produce the highest total returns. We continue to find value in the 11-21 year portion of the municipal yield curve in select "A" and "BBB" rated municipals in revenue bond sectors such as airports, gas bonds, healthcare, toll roads, and utilities. While credit spreads are tight, we believe spreads have room to tighten through 1Q 2025, particularly in January and February.

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.