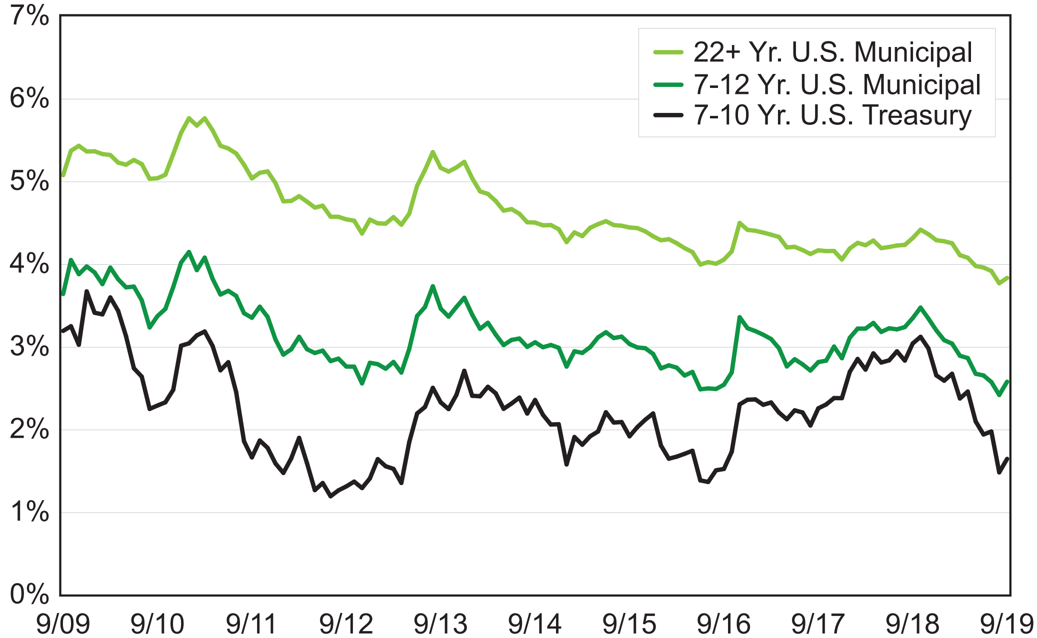
Yield Spreads Between Government And Municipal Bonds Favors Tax-Frees

Yield to Maturity (Treasuries vs. Municipals)



Source: Bloomberg. All three indices are ICE BofAML Bond Indices. Data points are month-end.
Past performance is no guarantee of future results.

View from the Observation Deck

1. Over the past 10 years (thru 9/30/19), the yield on the benchmark 10-year Treasury note fell from 3.31% to 1.67%, or a decline of 164 basis points, according to data from Bloomberg.
2. In that period, it set an all-time closing low of 1.36% on 7/8/16. The persistent climate of low interest rates and low government bond yields has likely inspired many investors to seek out higher-yielding alternatives, albeit with more inherent risk.
3. While most of these alternative income-oriented vehicles, such as corporate bonds, REITs and Utilities, generate taxable distributions, investors may also want to investigate municipal bonds.
4. Typically, the interest paid on the debt is exempt from federal income tax, but interest may also be exempt from state and local taxes if the bondholder lives in the state where the bond was issued.
5. As indicated by the bond indices in the chart, despite being federally tax-advantaged, the yields on the two municipal bond indices have exceeded the yield on the 7-10 year U.S. Treasury Index throughout the past decade. Historically, yields on municipal bonds would have been below those sported by government bonds.
6. Over the period depicted in the chart, the average yield spread between the 7-12 Year Municipal Securities Index and the 7-10 Year U.S. Treasury Index was 91 basis points, while the average yield spread between the 22+ Year Municipal Securities Index and the 7-10 Year U.S. Treasury Index was considerably higher at 238 basis points, according to Bloomberg.
7. As noted, while municipal bonds are riskier than government bonds, the good news is the historical default rate on municipal bonds is extremely low. From 2009-2018, the average five-year default rate was 0.16%, according to Moody's Investors Service.