The Week in Muniland

April 15, 2024

Screaming Buy

Munis remained resilient despite the rate volatility we saw this week. The Bloomberg Municipal Bond Index (Index) moved up to four basis points (bps) wider, with the belly of the curve underperforming short and long maturities. Munis outperformed US Treasuries (USTs) for the week, particularly in the front end of the yield curve. Two-, 10- and 30-year AAA municipal yields were flat, up 1 and 2 bps, respectively, while two-, 10- and 30-year UST yields rose 14, 13 and 8 bps, respectively. For the week, the Index returned –0.08% and is now down –1.11% year to date.

- **Why it matters:** It was a roller coaster of a week, but muni spreads were relatively stable despite the rate volatility. We can continue to see munis outperform USTs in the near term given the supportive technical backdrop, which includes relatively light dealer balance sheets, consistent inflows and manageable new issue supply. Despite the volatile macro backdrop, the $8.6 billion tax-exempt new issue supply was digested very easily. Deals priced with little to no concession still saw very strong demand. We particularly saw strong demand for some of the spreadier high-grade deals, with some ending up 10 to 15 times oversubscribed. All the supply was skewed toward high grades this week, with no high-yield supply. We didn't see any forced selling in the secondary market but saw plenty of buyers step in on days when yields were higher, as they were looking for more attractive buying opportunities.

US core CPI rose 0.4% month over month and 3.8% year over year in March, a 10th of a percent above expectations on both counts.

- **Why it matters:** Given renewed strength in the labor market and the bounce in prices, we don't expect the Fed to cut rates until December and expect it to cut only once this year. Yet to us, the entirety of the data is still showing a decelerating economy. The direction looks the same to us as it did earlier, but the timing looks extended (saying that with an enormous amount of humility). And it will be a bumpy ride. The Fed recently did a study that shows credit card delinquencies at their worst levels in a long time, above pre-pandemic levels. Credit card–interest payments are one transmission mechanism. The consumer is going to start slowing down spending at some point. The wage/price spiral is not happening as wage growth continues to come down. The Atlanta Fed's wage tracker dropped again this week. Non-seasonally adjusted initial jobless claims and continuing jobless claims are now both above pre-pandemic levels. The cleanest way to look at inflation is year over year so that you don't have to worry about seasonality problems—but if you do, core CPI in Q1 2024 is actually below core CPI in Q1 2023.

The beauty of bonds is they are math; as yields rise, bonds become more favorable for investors.

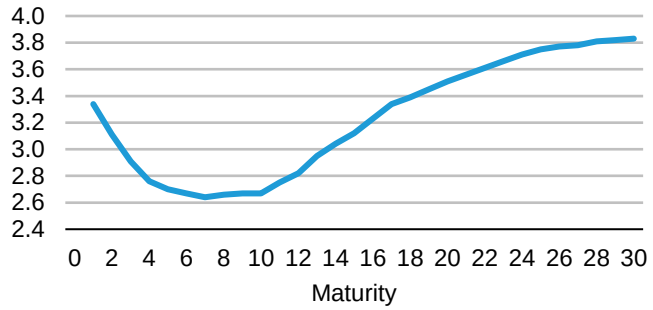
- **Why it matters:** While volatility has been prevalent over the past few weeks, investors should understand and be comfortable with today's advantageous bond math. For example, the Index has a yield to worst of 3.64% and a duration of 6.1 years. If 10-year UST yields rose another 100 bps to 5.53%, the Index would in essence break even from a return perspective. The –3.66% in price decline would be negated by +3.64% in income, showing the power or cushion that high levels of income provide to investors in a rising-rate environment. Conversely, if rates were to fall 100 bps, the expected return of the portfolio would be 7.30%. An investor's downside is flat to slightly positive, while still having significant upside embedded in the market. It's called fixed **income** for a reason, and high levels of income should be welcomed by long-term investors. And don't get caught up in when the Fed is going to cut and by how much. None of us wants to get back to a 1% yield environment anytime soon. Let's all enjoy the 4% yield environment for as long as we can. Fed cuts will come. Just be patient. Another way to view the attractiveness of bonds is their price. The Bloomberg BBB Muni Index has an average bond price of $95! In comparison, the average price in April 2021 was $111. The opportunity in bonds today is sizable.

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 15, 2024

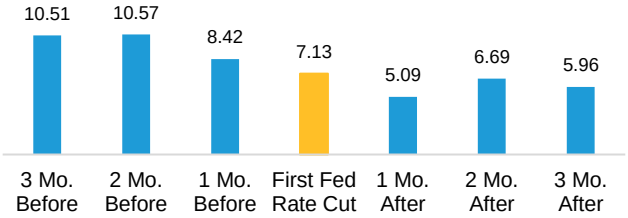
Display 1: AAA-Rated Municipal Yields (Percent)



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

As of April 12, 2024
Source: Municipal Market Data and AB

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



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

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

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

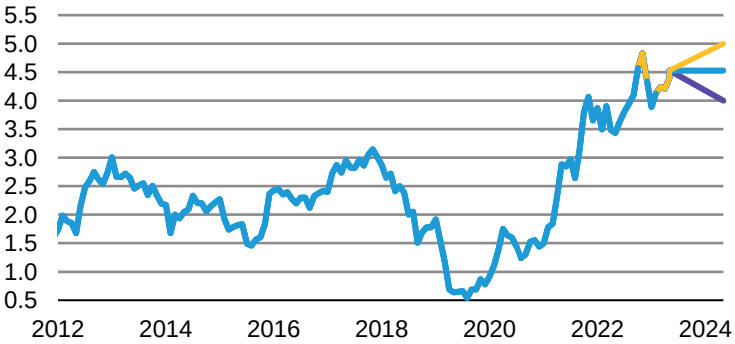
	Dec 31, 2023	Apr 12, 2024	Five-Year Average
Two-Year	–13	21	15
Five-Year	–15	-4	21
10-Year	–10	10	46
15-Year	39	67	71
20-Year	54	72	78
30-Year	94	103	93

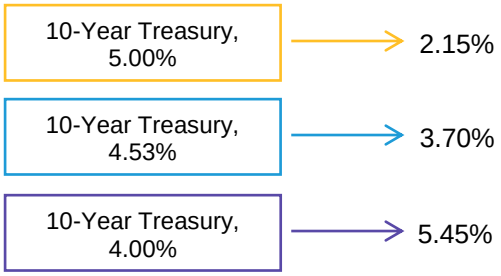
Shorter-maturity munis have recently cheapened relative to US Treasuries, although they are still relatively expensive versus US Treasuries for maturities of 5 to 10 years.

As of April 12, 2024
Source: Bloomberg and AB

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 12, 2024
Source: Bloomberg and AB

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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 l Not a bank deposit l Not insured by any federal government agency l No bank guarantee l May lose value

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