



4Q 2024

Municipal Basis Points

MUNICIPAL FIXED INCOME TEAM

A Wide-Open Market

- Municipalities accelerated issuance over the summer to get ahead of the federal election.
- As a result, municipal yields have become more attractive relative to Treasuries.
- With the Fed lowering rates, we think investors should put excess cash to work to secure higher tax-exempt incomes for longer.

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PRIVATE WEALTH



Macro and Markets

After a technically driven few months, we believe municipal bond valuations are compelling.

The municipal bond market rallied in the third quarter and delivered positive total returns despite a backdrop that continued to see record-setting levels of supply as issuers looked to pull deals forward in front of the U.S. election. For the quarter, the Bloomberg Barclays Municipal Bond Index generated a return of 2.71% and has now also provided positive year-to-date results.

While elevated supply has caused the muni market to lag other high-quality fixed income asset classes such as U.S. Treasuries, we have been impressed with how orderly the market has been, given that new issue volume is up 40% relative to the first nine months of 2023.¹ Dealers have been careful to build in appropriate price concessions for new issues to make sure they clear the market. Demand is clearly there when you consider that mutual fund flows have been positive by roughly \$25 billion since December.² Separately, managed account flows are a bit harder to track, but all signs point to strong flows in that investment vehicle, which continues to grow in popularity.

The bright side of all this supply is better valuations and more potential excess income on a taxable-equivalent basis. For example, intermediate munis ended the third quarter yielding roughly 2.83%, which equates to a taxable-equivalent yield of 4.78% or 112 basis points higher than intermediate Treasuries.³

Soft Landing and Solid Credits

From an economic standpoint, our base case remains for a soft landing for the U.S. economy. In our view, that should bode well for municipal credit quality, which already benefits from strong reserve levels and generally prudent fiscal management. Lower-rated investment grade (A and BBB rated) and high yield munis have meaningfully outperformed the highest-rated bonds so far this year. With nearly half of all municipal fund flows in 2024 going into high yield, we believe the market for lower-rated munis is well supported from both technical and economic standpoints. However, given the outperformance of lower-rated bonds over the past two years, security selection will likely be an important differentiator when adding any credit exposure moving forward. Our overall bias is “up in quality.”

Looking ahead, we remain constructive on the municipal market. We expect elevated supply to continue as we move closer to the election, which will give investors a unique opportunity to deploy capital and also participate in deals with price concessions. As mentioned, we believe muni valuations are attractive on a tax-adjusted basis. Finally, if volatility increases due to the U.S. election or geopolitical issues, we think munis will continue to deliver for investors as a safe-haven asset class.

¹ Source: Bloomberg.

² Source: Lipper.

³ Source: Bloomberg.

Strategy and Outlook

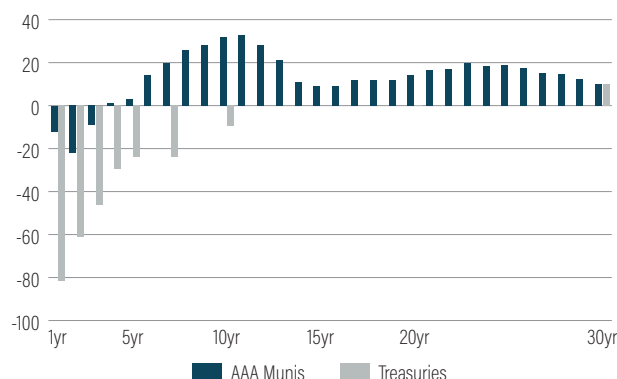
We see a timely opportunity to put cash to work in municipals.

Putting cash to work. In September, the Fed lowered interest rates by 50 basis points to recalibrate monetary policy, suggesting that it would prioritize employment as a consideration in future meetings to determine the path of monetary policy. As the Fed continues to reduce interest rates, we believe it could be time for investors to move out of cash and into intermediate/longer-maturity bonds to secure higher yields for longer.

Attractive municipal yields. Municipal rates have risen over the course of the year, diverging from declining U.S. Treasury yields, particularly during the summer given elevated new issuance. In our view, AAA and AA rated municipal bonds are currently fairly valued relative to Treasuries, but lower-rated munis may offer opportunity.

INCOME OPPORTUNITY

Municipal vs. Treasury Yield Change, Year-to-Date (Basis Points)



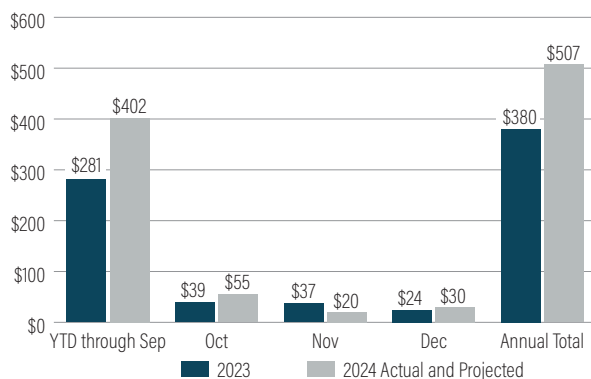
Source: Bloomberg, as of September 30, 2024.

Supply pull-forward. Demand remains strong despite robust new issue supply, which has experienced a 40% increase over the five-year average. September issuance

alone totaled \$46.8 billion or a 63% gain from a year earlier. Drivers of supply have included deals being pulled forward ahead of the presidential election, lower tax-exempt borrowing costs and municipalities replenishing federal COVID stimulus funds.

OVERFLOWING SUPPLY

Municipal Issuance, Actual and Projected (\$ Billions)



Source: Bloomberg, as of September 30, 2024.

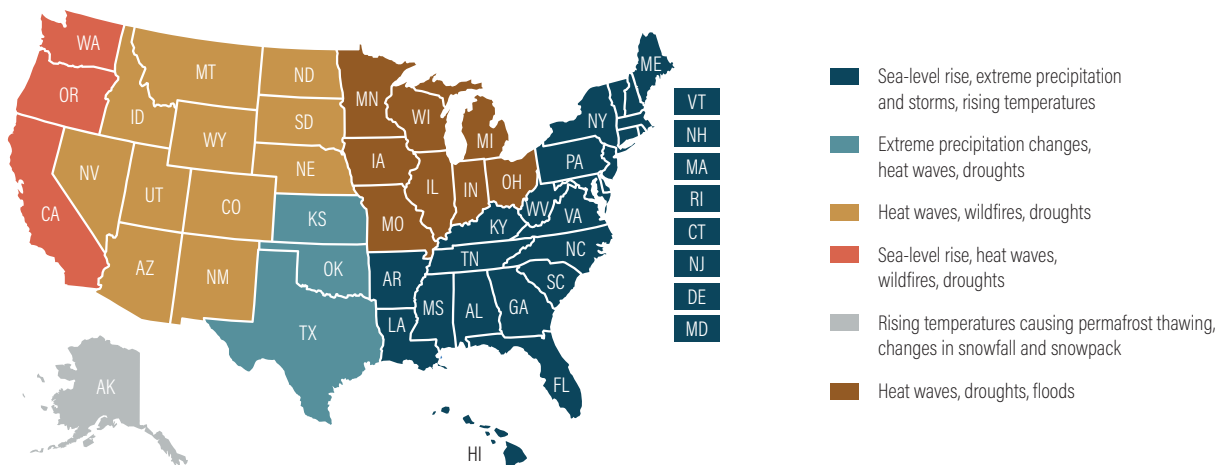
Intermediate and long-term bonds. We currently favor longer average maturities than our indices, a view we established during the spring. Longer bonds offer a steady stream of tax-exempt income, which could become more valuable as inflation moderates.

Credit fundamentals. If the economy does enter a recession, we think municipal credit fundamentals should remain solid given elevated tax collections (personal income, corporate, property and sales taxes). We believe that security selection, especially in the A and BBB credit-quality range, could be a key performance driver in the coming months.



The devastation caused by recent hurricanes to the southeastern United States underscores persistent climate risks facing the nation. It is crucial to recognize that every area of the country contends with distinct climate events, often resulting in severe safety threats and economic repercussions. Different regions remain more susceptible to specific storm and environmental risks, such as hurricanes in the southeastern states and wildfires in the western regions. While consistencies exist regarding what kind of storms or events typically affect an area, we now face the challenge of increasing severity and frequency of these events, as well as an expansion of affected geographical areas and extended storm seasons.

EXTREME WEATHER AND PROLONGED CLIMATE STRESSORS THROUGH 2100



Source: Allison R. Crimmins et al, Fifth National Climate Assessment, 2023, through Pew Charitable Trust.

In our view, addressing vulnerabilities to natural disasters requires issuers to develop tailored preparedness strategies to manage their unique threats. The implications of these strategies are substantial, posing challenges to local economies and government resources. Key concerns involve risk vulnerability, the financial implications of prevention and recovery efforts, and mitigation strategies to reduce the impact of these risks. Overall, we believe no government is entirely immune, highlighting the need for comprehensive strategies to mitigate these risks.

Putting Our Tools to Work

The municipal research team dedicates considerable time and resources to analyzing investments in state and local governments, assessing both their susceptibility to evolving climate and environmental event risks and their resilience from potential storms. Both aspects are critical to our analysis. We employ a proprietary research platform that uses various external data sources, including FEMA, the Environmental Protection Agency, the Centers for Disease Control and Prevention, and organizations providing heat and drought condition data.

While we have a detailed process in place that identifies those credits most susceptible to climate risk, we acknowledge that storms can travel, and that historical data may not be a predictor of future events. Therefore, our analysis of an issuer's financial resilience and legal provisions to repay debt are core components of our evaluation.

The municipal market has performed exceptionally well in terms of issuers repaying their debt obligations, but we remain conservative in our detailed analysis of each municipality. The increasing risks posed by storms and natural disasters require us to continually anticipate and adapt to an evolving investment environment and emphasize the importance of thorough climate analysis and insights.

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