



Investment Perspectives

Five Important Takeaways on Municipal Bonds and Market Volatility

Some key points for municipal bond investors to consider in an uncertain environment.



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Municipal bond investors have asked us about the market impact of the April 2 tariff announcements, a development that has broadly affected all asset classes. The upward move in rates across all markets is a result of the tariffs, which could lead to changes in monetary policy, stimulus of the U.S. economy through tax cuts, and potential inflationary impacts.

Here, we offer some insights on what municipal bond investors should focus on during this volatile period:

1. First and foremost, the credit quality of the municipal bond market remains strong and is likely not the reason for the sell-off. Most often, volatility in the municipal market is not due to inherent issues involving issuers' financial standing but rather outside factors; this was again the case in the early April sell-off.
2. These higher yields—at levels not seen for most of the past decade—should represent an attractive entry point for investors, and a significantly steep muni yield curve generously compensates investors for extending duration/interest rate risk, which is not the case in all bond markets.
3. Overall, we think the technical environment remains favorable. This is important, as new bond issue supply and retail demand can significantly affect municipal bond performance. Despite substantial selling by municipal bond exchange-traded funds (ETFs) in the April sell-off, overall trading has remained orderly, and broader outflow volume from municipal bond funds has not been overwhelming. While we expect demand may face headwinds in the short term, given the general uncertainty in markets, we believe the trend of positive fund flows prior to the tariff situation will restart and accelerate once rate volatility declines, given attractive tax-exempt yields and record levels of cash “on the sidelines” (i.e., held in instruments such as U.S. Treasury bills and money market funds). The rapid rise in yields has led to some new issuance being postponed, which temporarily reduces supply and alleviates some market pressure.
4. Taking a closer look at muni ETFs, we think it's important for investors to remember that the inefficiencies of these vehicles can lead to higher volatility. Unlike markets such as equities and Treasuries, as the outlook gets uncertain, the prices of muni ETFs can fall to substantial discounts to their NAVs causing dislocations. For example, as many ETFs were trading at discounts on April 7, speculators sold large volumes of cash bonds above the ETF discounts, but below market prices, seeking to make a profit, but with these trades pushing market prices lower over several days, these discounts eventually decreased. Overall, the higher volume of selling from ETFs on April 7 contributed to increased liquidity costs, causing municipals to underperform compared to Treasuries.
5. Separately managed accounts (SMAs) focused on municipal bonds experienced a slightly elevated level of withdrawals on April 7, but these remained manageable. There was a small number of account terminations where clients asked for all the bonds to be sold rather than just transferred to their brokerage account, indicating that a small number of clients needed to raise cash quickly for reasons such as margin calls. We believe the current market environment can potentially present a compelling opportunity for tax-loss harvesting, i.e., selling bonds to realize tax losses and purchasing new bonds at higher yields.



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A Final Word

We are confident that the municipal bond market continues to function well and offers attractive investment opportunities. While the recent tariff news has significantly affected markets, it's important to remember that municipal fundamentals remain solid, in our view. The municipal bond market has historically shown resilience through tougher economies. We believe the credit quality of muni-bond issuers will hold up well within the range of possible future scenarios. They are supported by a diverse range of revenue sources, including income, real estate and sales taxes, healthcare costs, university tuition, water and sewer fees, and toll expenses—all essential costs that people continue to pay even during periods of economic slowdown. Additionally, municipal bonds are a domestic asset class and are relatively insulated from the effects of tariffs.

In general, volatile markets like these can offer strong opportunities for active managers with credit research and security valuation expertise. As always, patience and balance will be key.



Glossary & Index Definitions

Exchange-traded funds (ETFs) are SEC-registered investment companies that offer investors a way to pool their money in a fund that invests in stocks, bonds, or other assets. In return, investors receive an interest in the fund.

Technical metrics in the municipal bond market include the supply of bonds available for purchase or are being brought to market, the demand for bonds from retail and other investors, and inflows and outflows from municipal bond mutual funds.

Yield is the income returned on an investment, such as the interest received from holding a security. The yield is usually expressed as an annual percentage rate based on the investment's cost, current market value, or face value. **Yield-to-maturity (YTM)** represents the expected return (expressed as an annualized rate) from the bond's future cash flows, including coupon payments over the life of the bond and the bond's principal value received at maturity. **Yield-to-worst** refers to the lesser of a bond's (a) yield-to-maturity or (b) the lowest yield-to-call calculated on each scheduled call date.

The **tax-equivalent yield** is the pretax yield that a taxable bond needs to possess for its yield to be equal to that of the tax-exempt yield on a municipal bond. This calculation can be used to fairly compare the yield of a tax-free bond to that of a taxable bond to see which bond has a higher applicable yield.

Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.

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The value of investments in fixed-income securities will change as interest rates fluctuate and in response to market movements. Generally, when interest rates rise, the prices of debt securities fall, and when interest rates fall, prices generally rise. High yield securities, sometimes called junk bonds, carry increased risks of price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Bonds may also be subject to other types of risk, such as call, credit, liquidity, and general market risks.

Longer-term debt securities are usually more sensitive to interest-rate changes; the longer the maturity of a security, the greater the effect a change in interest rates is likely to have on its price. There is a risk that a bond issued as tax-exempt may be reclassified by the IRS as taxable, creating taxable rather than tax-exempt income. Municipal bonds may be affected by local, state, and regional factors. These may include, for example, economic or political developments, erosion of the tax base, and the possibility of credit problems.

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