LORD ABBETT

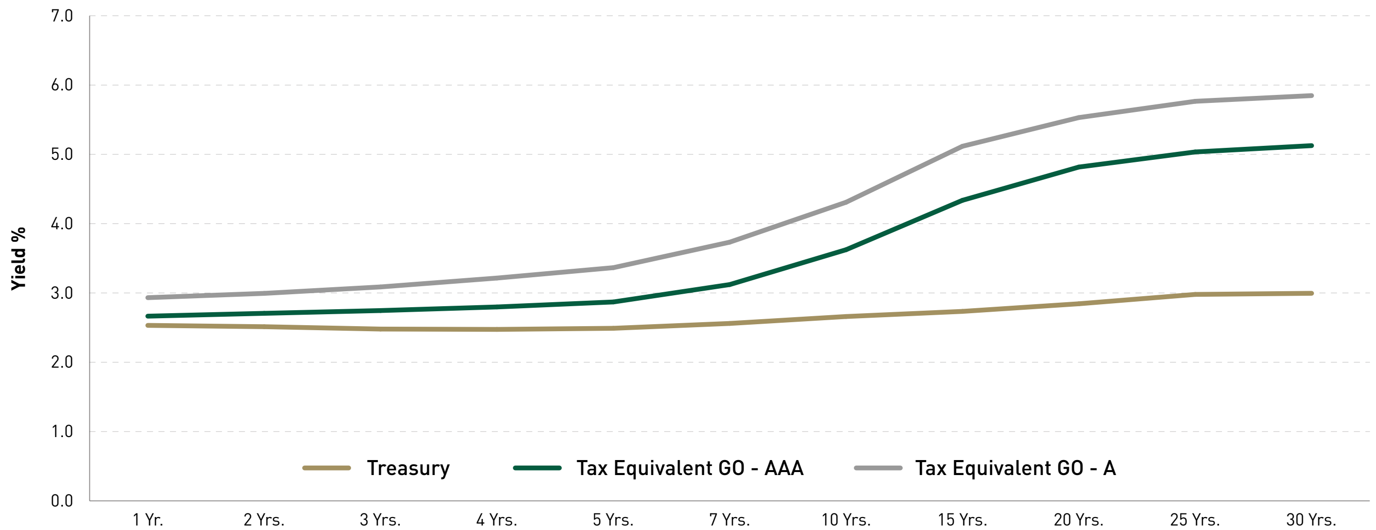
MARKET VIEW

FOUR REASONS TO CONSIDER MUNICIPAL BONDS

For those taking a fresh look at these tax-exempt securities, here are what we consider to be the most attractive features of the current muni market.

CHART 1. MUNICIPAL BONDS RECENTLY OFFERED HIGHER TAX-EQUIVALENT YIELDS RELATIVE TO TREASURIES

YIELD BY MATURITY, AS OF FEBRUARY 20, 2019



		AAA-RATED MUNIS			A-RATED MUNIS		
Term	Treasury Yield (%)	Yield (%)	TEY (%)	Yield Ratio to Treasuries	Yield (%)	TEY (%)	Yield Ratio to Treasuries
5 Years	2.49	1.70	2.87	115%	1.99	3.37	135%
10 Years	2.66	2.15	3.62	136%	2.55	4.31	162%
20 Years	2.84	2.85	4.82	169%	3.27	5.53	194%
30 Years	3.00	3.04	5.13	171%	3.46	5.85	195%

Source: Bloomberg. Data as of February 20, 2019. TEY=Tax-equivalent yield. Muni yields derived from maturity- and rating-specific components of the Bloomberg Barclays Municipal Bond Index. Treasury yields derived from maturity-specific components of the Bloomberg Barclays U.S. Treasury index. Tax-equivalent yield calculation for the municipal indexes above assumes the top marginal tax bracket of 40.8% on investment income, which includes the 37.0% income tax rate and the 3.8% in Medicare tax. This tax rate does not factor in the effect of AMT (alternative minimum tax) or taxes in your individual state. Tax-equivalent yield will vary based on an investor's tax bracket. Income from municipal bonds may be subject to the alternative minimum tax. Federal, state and local taxes may apply. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. **Past performance is not a reliable indicator or guarantee of future results.**

IN BRIEF

- Headlines regarding the impact of the $10,000 cap on deductions for state and local taxes may prompt investors looking for tax-exempt income to consider municipal bonds.
- Here, we review what, in our opinion, are four salient features of the current municipal bond market: issuer credit quality, yields, long-term performance, and market supply/demand dynamics.
- We believe that investors wary of the effect of tax-law changes may find that today's muni market offers some attractive features and sources of value.

FEATURED MANAGER

Daniel S. Solender, CFA
Partner & Director

A recent Bloomberg opinion piece noted that two of the most popular articles on the eponymous terminal during the week of February 14 spotlighted the rising appeal of tax-free municipal bonds.[1] In particular, the articles in question cited concerns among taxpayers in certain states about the effect of the recently imposed $10,000 limit on the deduction of state and local taxes (SALT) on their 2018 tax liabilities.

We at Lord Abbett have been keeping an eye on this trend for a while now. Our director of municipal bonds, Dan Solender, had flagged the potential impact of the SALT cap on muni-bond investment decisions in remarks made during our 2018 year-end investment roundtable. He followed that up with a February 7 *Muni Matters* column on why investors facing "SALT shock" might wish to consider muni bonds.

With tax-preparation season for 2018 returns in full swing, this week's *Market View* will draw on some of Solender's observations—along with other data—to give readers an update on key attributes of the current municipal bond market.

1. Credit Quality

Solender noted that "overall, the credit quality of municipal bonds remains strong." In 2018, the major U.S. rating agencies issued more upgrades than downgrades on rated muni debt. Solender observed that based on reports from state governments, tax receipts for many U.S. states—key issuers of general obligation bonds—"came in higher, and above budget targets, all around the country."

2. Yields

Recent municipal bond yields have looked attractive compared to other markets, according to Solender. As Chart 1 shows, as of February 20, 2019, the 30-year yield for AAA-rated bonds was virtually the same as a U.S. Treasury bond of identical maturity, even though municipal bonds are federally tax exempt. The 10-year AAA muni yield was more than 80% of similarly dated Treasuries, a condition which Solender deems "attractive" when considering tax-equivalent yields which gross up the municipal bond yield to reflect the tax advantage. He noted that while shorter-dated muni bonds trade at lower ratios to Treasuries, he believes "they retain their appeal for risk-averse investors."

Investors considering munis in the current tax environment should note that yields have risen substantially since the lows of July 2016, said Solender; when looking at yields on a tax-equivalent basis, the difference is even greater. For those worried about another move higher in rates, and how it might affect their municipal bond investments, Solender believes they can take comfort in knowing that since the U.S. Federal Reserve started raising rates in December 2015, the total returns of all maturities of the muni-bond indexes compiled by Bloomberg Barclays Indices (through February 20, 2019) have been positive. [*Of course, municipal bonds may not perform in the same way under similar circumstances in the future.*]

3. Long-Term Performance

Taking a longer view, municipal bonds have put in a solidly positive performance over the past two decades, with only three negative years for the benchmark Bloomberg Barclays Municipal Bond Index (the muni index) since 1996, as shown in Chart 2 on the following page. Further, the muni index, its longer-term components, and the Bloomberg Barclays High Yield Municipal Bond Index have outperformed the broader bond market, as represented by the Bloomberg Barclays U.S. Aggregate Bond Index, over the past three, five, seven, and 10 years through January 31, 2019 (see table at bottom of Chart 2).

4. Supply/Demand Dynamics

Provisions of the 2017 tax bill eliminated the issuance of advance refunding bonds, which allowed issuers to refinance their outstanding bonds prior to their call date. As this type of issuance typically represented more than one-fifth of the new issue market, the overall supply of newly issued municipal bonds decreased by more than 20% in 2018 compared to the previous year, according to *The Bond Buyer*. Solender said that while the new issue supply is likely to be slightly higher in 2019, he thinks it is unlikely to get back to the levels of previous years. With the elimination of advanced refunding bonds also leading to a decrease in the amount of short-term munis outstanding, supply/demand dynamics should continue to be supportive for the municipal bond market in 2019, according to Solender.

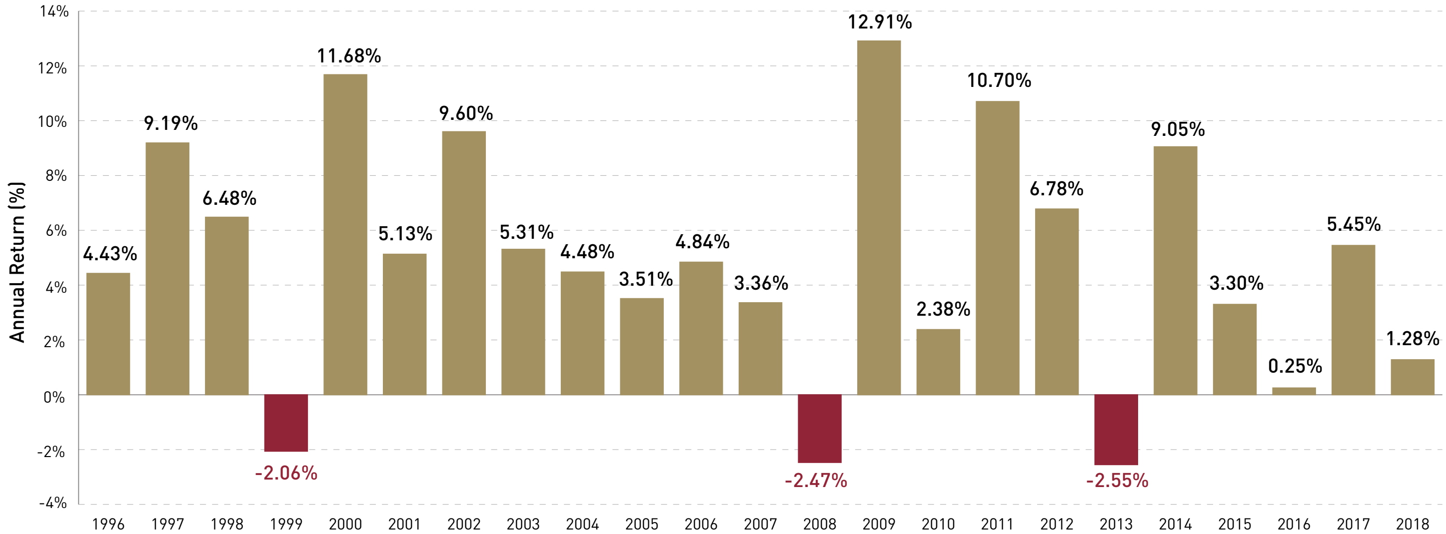
Summing Up

As Solender noted in his recent column, municipal bonds performed well during the late-year volatility in 2018. That strength, coupled with the factors mentioned here, may lend additional appeal to this long-established asset class. For investors wary of how the SALT cap and other tax-law changes may affect their liabilities for 2018 and subsequent tax years, a fresh look at today's muni-bond market may reveal "some attractive features and sources of value," said Solender. ■

[1]Brian Chappatta, "Nothing Is Certain But Death, Taxes and Muni Bond Advantages," Bloomberg, February 14, 2019.

CHART 2. HOW HAVE MUNICIPAL BONDS PERFORMED OVER THE LONGER TERM?

ANNUAL RETURNS OF THE BLOOMBERG BARCLAYS MUNICIPAL BOND INDEX, 1996–2018



Returns as of 01/31/2019	3 Years	5 Years	7 Years	10 Years
Bloomberg Barclays U.S. Aggregate Bond Index	2.0	2.4	2.1	3.7
Bloomberg Barclays Municipal Bond Index	2.2	3.6	3.1	4.6
Muni - 7 Year	1.8	2.9	2.6	3.7
Muni - 10 Year	2.2	3.7	3.2	4.5
Muni - 22+ Year	2.9	5.2	4.3	6.7
Bloomberg Barclays High Yield Municipal Bond Index	5.8	6.0	5.8	8.6

Source: Bloomberg Barclays Indices. Data as of January 31, 2019.

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Diversification does not ensure a profit or protect against a loss in a declining market.

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Statements concerning financial market trends are based on current market conditions, which will fluctuate. There is no guarantee that markets will perform in a similar manner under similar conditions in the future.

Treasuries are debt securities issued by the U.S. government and secured by its full faith and credit. Income from Treasury securities is exempt from state and local taxes.

Yield is the annual interest received from a bond and is typically expressed as a percentage of the bond's market price. The **average yield** is the market-value-weighted average yield to maturity of a portfolio of bonds.

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

The **Bloomberg Barclays High Yield Municipal Bond Index** is an unmanaged index consisting of noninvestment-grade, unrated or below Ba1 bonds.

The **Bloomberg Barclays Municipal Bond Index** a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market. Bonds must be rated investment-grade (Baa3/BBB- or higher) by at least two ratings agencies. They must have an outstanding par value of at least $7 million and be issued as part of a transaction of at least $75 million. The bonds must be fixed rate, have a dated-date after December 31, 1990, and must be at least one year from their maturity date.

The **Bloomberg Barclays U.S. Aggregate Bond Index** represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. Total return comprises price appreciation/depreciation and income as a percentage of the original investment.

The **Bloomberg Barclays U.S. Treasury Index** is the U.S. Treasury component of the Bloomberg Barclays U.S. Government Index. The index includes public obligations of the U.S. Treasury with a remaining maturity of one year or more.

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