



Surveying Potential Opportunities in Municipal Bonds

Here, we summarize recent insights on key segments of the municipal bond market.



John George
Product Consultant



Matthew Schaller, CFA
Product Consultant

Figure 1. High Yield Municipal Bond Spreads Remain Wide

Spread of Bloomberg Barclays High Yield Municipal Bond Index versus Bloomberg Barclays Municipal Bond Index, January 1, 2005–July 10, 2020



Source: Bloomberg. Data as of July 10, 2020.

Spread is the percentage difference in current yields of various classes of fixed-income securities versus another benchmark bond measure. A bond spread is often expressed as a difference in percentage points or basis points (one one-hundredth of a percentage point).

Past performance is not a reliable indicator or guarantee of future results. For illustrative purposes only and does not represent any specific portfolio managed by Lord Abbett or any particular investment. Indexes are unmanaged, do not reflect the deduction of fees or expenses, and are not available for direct investment.



In the June 8, 2020, *Market View*, we discussed [opportunities across the risk spectrum](#) among U.S. equities and taxable fixed income investments. That piece got a strong response from readers and prompted requests for a similar survey of potential investment choices within the municipal bond space.

Requests granted. Here, we examine four potentially appealing muni segments, drawing on the insights of Lord Abbett Partner and Director of Municipal Bonds, [Dan Solender](#).

Higher Quality Municipal Bonds

After a difficult March, municipal bond prices started recovering in April in the high-quality segment of the market, with the rebound subsequently extending to bonds in lower rating categories as we entered June. One of the turning points for the market was when the U.S. Federal Reserve (Fed) decided to find ways to extend support to municipal bonds, culminating in [the creation of the Municipal Liquidity Facility \(MLF\)](#), announced on April 9.

Higher quality municipal bonds have rallied since their year-to-date lows in the middle of March. Despite being down by as much as 7.5% in mid-March, the primarily investment grade Bloomberg Barclays Municipal Bond Index has recovered, returning 2.43% year-to-date (through July 9), paced by strong performance in AAA and AA rated bonds.

Based on data from JP Morgan, the ratio of municipal bond yields to Treasury yields remains elevated, though well below the extreme levels seen in March. As of July 6, the yield ratio on AAA-rated municipal bonds was 176% for maturities of two years, 138% for five years, 134% for 10 years, and 114% for 30 years. The fact that ratios remain well above historical averages suggests that tax-equivalent yields among higher-rated municipal bonds present attractive relative value.

Intermediate-Term Municipal Bonds

As Solender noted in [a detailed summary of the potential appeal of intermediate-term municipal bonds](#) published on June 3, intermediate-term muni bonds represent the largest weighting of assets in municipal bond mutual funds. The reasons for their popularity are understandable, he notes, as they:

- Have had lower volatility than longer muni bonds,
- feature more attractive yield ratios versus Treasury bonds than shorter muni maturities,
- have attractive risk/return characteristics, and
- typically have had high expected total returns due to steepness of the yield curve.

High Yield Municipal Bonds

Investors looking to take advantage of relatively “cheap” municipal bonds, attractive tax-equivalent yields, and the potential benefits created by the MLF, may wish to consider high yield municipal bonds. There is a notable incremental yield advantage as you move lower on the credit spectrum.

To be sure, the high yield segment of the muni market came under significant pressure during the March market turmoil. Even more striking, after all the elevated volatility in March, the Bloomberg Barclays High Yield Municipal Bond Index was down only 2.07% year to date through July 9, and still had a positive 12-month return of 1.36%. Factor in munis’ tax-exempt status, and the tax-equivalent return would be roughly comparable to some other fixed income investments. We believe forced liquidations of bonds in many funds created a “fire-sale” price environment for the high yield market and these credits are still relatively attractive. Indeed, spreads remain near multi-year highs, as seen in Figure 1 on the first page. Should the market continue to stabilize, these spreads may represent an attractive entry point for municipal bond investors.

In terms of credit fundamentals, [high yield municipal bonds have had much lower historical default rates than comparably rated corporates](#). We believe this dynamic will not change, despite concern from market participants in response to the coronavirus outbreak. In our view, investors have largely factored minor ratings downgrades and select negative outlooks from ratings agencies into the prices of securities.

MUNICIPAL BONDS



Revenue Bonds

Revenue bonds have underperformed the broader municipal market thus far in 2020 (through July 9), as investors have favored bonds in the upper credit quality tiers. In [a recent commentary](#), Solender noted that revenue bonds' credit quality "is still very strong" and fits into the range of the investment grade market, which has historical default rates close to 0%, based on a 2019 Moody's study. Further, the subset of the Bloomberg Barclays Municipal Bond Index that tracks revenue bonds has outperformed the general obligation (GO) bond subindex in five of the past six years.

In our view, the entities supporting sectors within the revenue bond universe that supply essential services (for example, utilities, water systems, transportation, ports) are poised to remain in solid financial condition as the U.S. economy stabilizes. We believe these sectors are well positioned to support their obligations through this environment.

A Final Word

As always, investors must make decisions regarding whether to target yield or total return and how much risk they want to take. As Solender put it in [his June 24 commentary](#), "while municipal bonds have been recovering well from the March downturn, we think there are still intriguing opportunities to consider as the market continues to rebound."

This *Market View* may contain assumptions that are "forward-looking statements," which are based on certain assumptions of future events. Actual events are difficult to predict and may differ from those assumed. There can be no assurance that forward-looking statements will materialize or that actual returns or results will not be materially different from those described here.

This material is provided for general and educational purposes only. It is not intended as an offer or solicitation for the purchase or sale of any financial instrument, or any Lord Abbett product or strategy. References to specific asset classes and financial markets are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations or investment advice.

A Note about Risk: The value of an investment in fixed-income securities will change as interest rates fluctuate and in response to market movements. As interest rates fall, the prices of debt securities tend to rise. As rates rise, prices tend to fall. Investing in the bond market is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The municipal bond market may be impacted by unfavorable legislative or political developments and adverse changes in the financial conditions of state and municipal issuers or the federal government in case it provides financial support to the municipality. Income from the municipal bonds held could be declared taxable because of changes in tax laws. Certain sectors of the municipal bond market have special risks that can affect them more significantly than the market as a whole. Because many municipal instruments are issued to finance similar projects, conditions in these industries can significantly affect an investment. Income from municipal bonds may be subject to the alternative minimum tax. Federal, state and local taxes may apply. Investments in Puerto Rico and other U.S. territories, commonwealths, and possessions 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.

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.

The **Bloomberg Barclays Municipal Bond Index** is a rules-based, market-value-weighted index engineered for the long-term tax-exempt bond market. The index is a broad measure of the municipal bond market with maturities of at least one year. Bonds 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 **Bloomberg Barclays High Yield Municipal Bond Index** is an unmanaged index consisting of noninvestment-grade, unrated or below Ba1 bonds.

Bloomberg Barclays Index Information:

Source: Bloomberg Index Services Limited. BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. and its affiliates (collectively "Bloomberg"). BARCLAYS® is a trademark and service mark of

Barclays Bank Plc (collectively with its affiliates, "Barclays"), used under license. Bloomberg or Bloomberg's licensors, including Barclays, own all proprietary rights in the Bloomberg Barclays Indices. Neither Bloomberg nor Barclays approves or endorses this material, or guarantees the accuracy or completeness of any information herein, or makes any warranty, express or implied, as to the results to be obtained therefrom and, to the maximum extent allowed by law, neither shall have any liability or responsibility for injury or damages arising in connection therewith.

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

The credit quality of the securities in a portfolio are assigned by a nationally recognized statistical rating organization (NRSRO), such as Standard & Poor's, Moody's, or Fitch, as an indication of an issuer's creditworthiness. Ratings range from 'AAA' (highest) to 'D' (lowest). Bonds rated 'BBB' or above are considered investment grade. Credit ratings 'BB' and below are lower-rated securities (junk bonds). High-yielding, non-investment-grade bonds (junk bonds) involve higher risks than investment-grade bonds. Adverse conditions may affect the issuer's ability to pay interest and principal on these securities.

No investing strategy can overcome all market volatility or guarantee future results. 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.

The information provided is not directed at any investor or category of investors and is provided solely as general information about Lord Abbett's products and services and to otherwise provide general investment education. None of the information provided should be regarded as a suggestion to engage in or refrain from any investment-related course of action as neither Lord Abbett nor its affiliates are undertaking to provide impartial investment advice, act as an impartial adviser, or give advice in a fiduciary capacity. If you are an individual retirement investor, contact your financial advisor or other fiduciary about whether any given investment idea, strategy, product or service may be appropriate for your circumstances.

The opinions in this *Market View* are as of the date of publication, are subject to change based on subsequent developments, and may not reflect the views of the firm as a whole. The material is not intended to be relied upon as a forecast, research, or investment advice, is not a recommendation or offer to buy or sell any securities or to adopt any investment strategy, and is not intended to predict or depict the performance of any investment. Readers should not assume that investments in companies, securities, sectors, and/or markets described were or will be profitable. Investing involves risk, including possible loss of principal. This document is prepared based on the information Lord Abbett deems reliable; however, Lord Abbett does not warrant the accuracy and completeness of the information. Investors should consult with a financial advisor prior to making an investment decision.

Investors should carefully consider the investment objectives, risks, charges, and expenses of the Lord Abbett funds. This and other important information is contained in each fund's summary prospectus and/or prospectus. To obtain a prospectus or summary prospectus on any Lord Abbett mutual fund, contact your investment professional or Lord Abbett Distributor LLC at 888-522-2388, or visit us at lordabbett.com. Read the prospectus carefully before you invest.