Advisory Blog

Timely insights on the issues that matter most to advisors and their clients

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Inflation | Municipal Bonds | Volatility

EV Forward: Municipal Bonds

By: EV Forward | July 6, 2022

Boston - At current valuations, municipals appear attractive for crossover buyers, which could provide some much-needed support for the market.

What we are seeing

The municipal market is in the midst of a historic outflow cycle: Through mid-June, municipal bond funds have experienced $73 billion in outflows — making this the worst outflow cycle dating back to 1992.

The outflows have resulted in significant selling pressure, and much improved value, as muni yields have increased 150 to 190 basis points (bps) across the curve since the beginning of the year.

Entering the summer months, municipal technicals on the supply side may turn supportive, with an estimated negative $33 billion in net supply potentially providing support for current price levels.

What we are doing

Volatility in the muni market has created opportunities within rating categories, sectors and coupon structures; we have used relative value trading to take advantage of these inefficiencies.

The front end of the yield curve remains attractive, and with the significant increase in yields on the long end of the curve, we are now assessing longer duration opportunities.

We are taking advantage of pockets of liquidity to sell bonds when certain demand arises from retail investors, banks and insurance companies.

We are redeploying capital in times of stress, when there are forced sellers in the market.

What we are watching

Through mid-June, the Bloomberg Municipal Bond Index is down -10% — theworst start to the year for municipals in 40 years. Historically, sharp increases in municipal yields have been followed by rewarding 6-month and 12-month returns for municipal bonds. After 23 straight weeks of fund outflows, we are watching and waiting for fund flows to turn around, which could help trigger a rally in municipals.

The Federal Reserve is in the precarious position of combating persistent inflation while avoiding a recession. Given that the fed funds rate is now 1.75%, we are watching inflationary pressures to see if the anticipated 175 bps of additional monetary tightening by year-end is realistic.

We are actively assessing ratios of tax-exempt municipals to Treasurys, taxable municipals and investment-grade corporate bonds. At current valuations, municipals appear attractive for crossover buyers, which could provide some much-needed support for the market.

Bill Delahunty, CFA
Portfolio Manager

Trevor Smith
Portfolio Manager

Bloomberg Municipal Bond Index is an unmanaged index of municipal bonds traded in the U.S.

Past performance is no guarantee of future results. The returns referred to in the commentary are those of representative indexes and are not meant to depict the performance of a specific investment.

Risk Considerations: *An imbalance in supply and demand in the municipal market may result in valuation uncertainties and greater volatility, less liquidity, widening credit spreads and a lack of price transparency in the market. There generally is limited public information about municipal issuers. Investments in income securities may be affected by changes in the creditworthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer's ability to make principal and interest payments. As interest rates rise, the value of certain income investments is likely to decline. Investments involving higher risk do not necessarily mean higher return potential. Diversification cannot ensure a profit or eliminate the risk of loss. Debt securities are subject to risks that the issuer will not meet its payment obligations.*

EV Forward

> We believe times like these underscore the value of active management — carefully assessing the fluctuations driven by all kinds of disruptions, and taking dynamic actions that best serve the long-term interests of our clients.