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 | August 3, 2022

New York - Should the inflation data ease and fund outflows stop, we think the municipal market is well situated to put in a strong performance in the second half of the year.

What we are seeing

Investors have responded to notably higher yields inside of five years, and the municipal curve has steepened since May, even as the Treasury curve has inverted. Municipals are now trending more expensive in first few years of the curve, but they are fairly valued in five years and cheaper further out compared to their five-year averages. However, increased Treasury volatility is also increasing ratio volatility.

We continue to see an opportunistic entry point for investors in high tax brackets who are looking to put some cash to work. The upward move in rates is impacting the coupon structure of new issue deals, with increased issuance of 4% and 5% coupons.

What we are doing

Much as before, we are staying the course, and we think municipal investors may want to consider doing the same.

Generally, selling a security that is trading at a loss creates a realized tax loss, which can be used to offset realized capital gains from this year, or carried over to future tax years. We continue to *harvest tax losses* as part of our ongoing tax loss harvesting process whenever we see opportunities.

For total return strategies, rate volatility is still creating inefficiencies that we can take advantage of. When the opportunity presents itself, we are "couponing up" — that's, moving up to higher coupon bonds with shorter durations and wider spreads.

What we are watching

Overall, the stage looks to be set for a better second half in the municipal market, with the increased yields appearing to attract investors in separately managed accounts (SMAs). The supply/demand dynamic has shifted favorably, as the summer underwriting calendar is light, and reinvestment flows from called and maturing bonds are expected to exceed issuance.

Funds are still seeing outflows, though they are slowing significantly. Until that trend comes to an end, it is likely to temper any rally in the market. Should the inflation data ease and fund outflows stop, we think the municipal market is well situated to put in a strong performance in the second half of the year.

Evan Rourke, CFA
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For more insights on navigating higher inflation, please visit the Inflation Resource Center

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Tax-loss harvesting involves certain risks including, among others, the risk that the new investment could perform worse than the original investment and that transaction cost could offset the tax benefit. There may also be unintended tax implications. Prospective investors should consult with a tax or legal advisor before making any investment decision.

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.

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