

Advisory Blog

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

Disclosure



The views expressed in these posts are those of the authors and are current only through the date stated. These views are subject to change at any time based upon market or other conditions, and Eaton Vance disclaims any responsibility to update such views. These views may not be relied upon as investment advice and, because investment decisions for Eaton Vance are based on many factors, may not be relied upon as an indication of trading intent on behalf of any Eaton Vance fund. The discussion herein is general in nature and is provided for informational purposes only. There is no guarantee as to its accuracy or completeness. Past performance is no guarantee of future results.

[Municipal Bonds](#) | [Navigating the Curve](#)

High Yield Municipal Bonds: Now May Be a Good Time to Invest

By: Bill Delahunty, CFA | & Cynthia J. Clemson | September 7, 2023

KEY POINTS

1. High yield municipal bonds are even more attractive, based on both absolute yields and spreads.
2. Based on snapbacks from past sell-offs and Fed tightening cycles, this HY muni rally may still have room to run.
3. Whether the economy moves to a soft landing or recession, we believe high quality HY munis can hold up well.

Boston - High yield municipal bond performance has been impressive so far in 2023. Despite this, we believe there are three reasons why now is still a good time to invest in HY muni bonds.

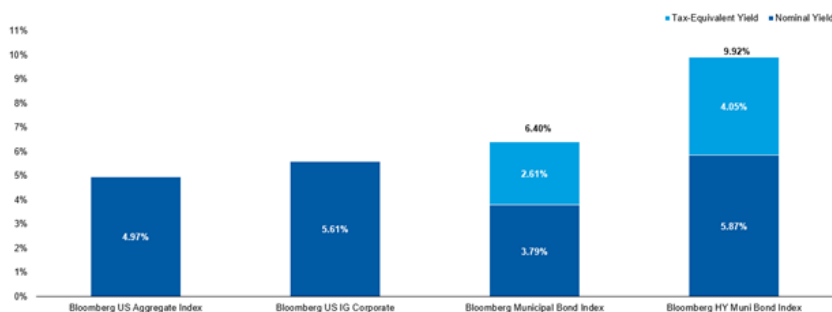
Attractive current spreads and yields

At 250 basis points (bps) relative to AAA municipal bonds, HY muni spreads remain attractive. They are now slightly wider than their five-year average, 92 bps wider than at the start of 2022 and 35 bps wider than one year ago. While spreads are attractive, they are not at the "wides" we have seen during times of stress, like the onset of the COVID pandemic in Spring 2020 or the Global Financial Crisis in 2008.

At 5.87%, the yield on the Bloomberg High Yield Municipal Bond Index¹ is even more attractive. This yield is 273 bps higher than at the start of 2022 and up 53 bps from one year ago. Aside from a short period of time last year and during the COVID-driven turmoil in Spring 2020, the last time the HY index yielded this much was in early 2017.

Taxable Equivalent Yields

Municipal taxable-equivalent yields appear very attractive relative to other high quality options.



Source: Barclays Live as of August 30, 2023, Tax Policy Center. This table is for illustrative purposes only and uses the highest current applicable federal tax rates plus 3.8% health care tax. Past performance is no guarantee of future results. It is not possible to invest directly in an index.

Still room to run for HY muni rally

Since 2009, there have been five major sell-offs in the HY muni market. In the recovery from each low point, on average, the benchmark has generated approximately a 20% total return over the next 12 months. The HY muni index has returned 9.2% in the 10 months since its low in October 2022. Based on the historical experience, we believe there could be more room for HY munis to run.

Besides that, the U.S. Federal Reserve is broadly believed to be at or near the end of this rate tightening cycle. During the Fed's last three rate rising cycles in 2000, 2006 and 2018, the HY Muni Index generated an average return of 9.23% over the 12 months after the final rate hike. Therefore, if the Fed is done, we think it could be a good time to move some cash into HY munis.

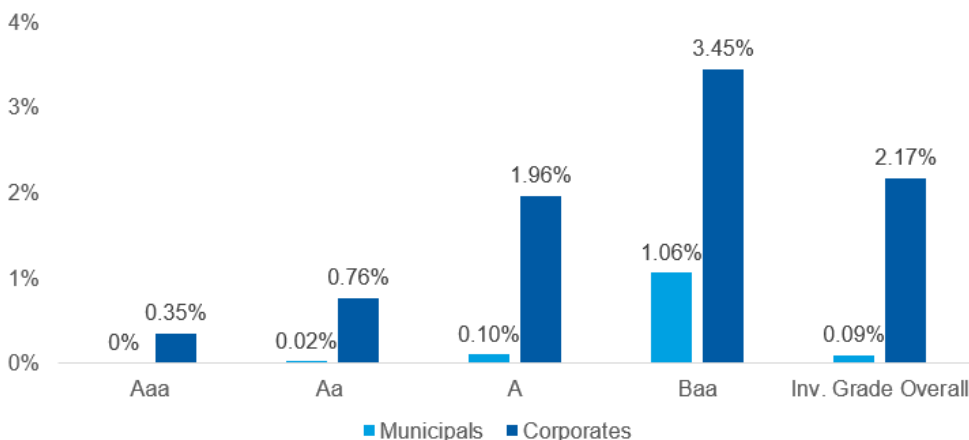
Soft landing or recession, focus on high quality HY munis

Again, HY muni spreads are 66 bps *wider* than they were a year ago, in contrast to the HY corporate bond market, where spreads are 63 bps *tighter* than at this point last year. According to a recent report from Bank of America (BofA), "corporate credit spreads are [currently] trading as if the economy will avoid a recession. Muni spreads are lagging far behind." In the event of a soft landing, BofA estimates that for muni credit spreads to match corporates, the HY muni high yield index spread would have to narrow approximately 70 bps.

If there is no soft landing, we could enter a recession at some point later this year or next, which could lead to some credit weakening. However, according to Moody's, based on data from 1970 to 2021, default rates have been significantly lower for municipals than for corporates over time.

Default Rates: Municipals vs. Corporates

The default rate in munis has been considerably lower than corporates over time



Source: Moody's Investors Service: US Municipal Bond Defaults and Recoveries, 1970-2021.

We believe that owning high quality assets is key in a recessionary environment. Investing in higher quality HY munis rated BBB or in the upper end of the below investment grade market is our preference. Being very selective in non-rated credits is also important, as they tend to be the most speculative credits in the market.

Bottom line: We have reviewed the reasons why we believe that it is an attractive time to invest in the HY muni market. Furthermore, through June 30, the HY muni index has outperformed the Bloomberg Municipal Bond Index² over three, five, 10 and 15 years. Therefore, based on this evidence, investors may want to consider HY municipal bonds as a core allocation in their portfolios.

¹ Bloomberg High Yield Municipal Bond Index is an unmanaged index of non-investment grade municipal bonds traded in the U.S.

² Bloomberg Municipal Bond Index is an unmanaged index of municipal bonds traded in the U.S.

Risk Considerations: The value of investments may increase or decrease in response to economic, and financial events (whether real, expected or perceived) in the U.S. and global markets. 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 risks that the issuer will not meet its payment obligations. Low rated or equivalent unrated debt securities of the type in which a strategy will invest generally offer a higher return than higher rated debt securities, but also are subject to greater risks that the issuer will default. Unrated bonds are generally regarded as being speculative. Mortgage and asset-backed securities are sensitive to early prepayment risk and a higher risk of default and may be hard to value and difficult to sell (liquidity risk). They are also subject to credit, market and interest rate risks.



Bill Delahunty, CFA
Portfolio Manager
Municipals



Cynthia J. Clemson
Co-Head of Municipals
Portfolio Manager

"We never advocate for market timing, but investors may want to consider high yield municipal bonds as a core allocation in their portfolios."



To report a website vulnerability, please go to [Responsible Disclosure](#).

Eaton Vance is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley.

For USA PATRIOT Act Disclosure Notice please click [here](#).

 This image indicates content designed specifically for Financial Advisors / Investment Professionals. This material is not to be used with the public.

Before investing in any Eaton Vance, Calvert or Morgan Stanley Investment Management Inc.-advised fund, prospective investors should consider carefully the investment objective(s), risks, and charges and expenses. Read the prospectus carefully before you invest or send money. For **open-end mutual funds**, the current prospectus contains this and other information. To obtain an **open-end mutual fund** prospectus or summary prospectus and the most recent annual and semiannual shareholder reports, contact your financial advisor or [download a copy here](#). For **closed-end funds**, you should contact your financial advisor. To obtain the most recent annual and semi-annual shareholder report for a closed-end fund contact your financial advisor or [download a copy here](#). To obtain an **exchange-traded fund**, ("ETF") prospectus or summary prospectus, contact your financial advisor or [download a copy here](#).

Before purchasing any **variable product**, consider the objectives, risks, charges, and expenses associated with the underlying investment option(s) and those of the product itself. For a prospectus containing this and other information, contact your investment or insurance professional. Read the prospectus carefully before investing.

NOT FDIC INSURED | OFFER NO BANK GUARANTEE | MAY LOSE VALUE | NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY | NOT A DEPOSIT

Eaton Vance does not provide tax or legal advice. Prospective investors should consult with a tax or legal advisor before making any investment decision. The information on this Web page is for U.S. residents only and does not constitute an offer to sell, or a solicitation of an offer to purchase, securities in any jurisdiction to any person to whom it is not lawful to make such an offer.

© Eaton Vance Management. All rights reserved.

Eaton Vance open-end mutual funds are offered through Eaton Vance Distributors, Inc. Two International Place, Boston, MA 02110. Member [FINRA](#) / [SIPC](#). Exchange-traded funds are distributed by Foreside Fund Services, LLC.