

Challenging Conditions for Munis

Tight ratios and spreads provide limited buffer against a market dislocation.

Both tax-exempt and taxable municipal bonds continue to perform well on a total return basis, but we expect tax exempt valuations to widen as technical headwinds increase. Look for bargains among esoteric credits as traditional higher quality sectors remain richly valued.

Sector Commentary

- Tax exempts closed 2024 on a sour note as valuations remained tight while liquidity dried up. Municipals returned negative 1.5 percent in December, reducing full year returns to 1 percent. Front-end tax-exempt-to-Treasury-yield ratios generally moved higher over the last 12 months, although the 30-year ratio tightened as traditional buyers extended their interest rate exposure.
- January principal and interest payments tend to generate positive momentum that peters out by mid-February. Expectations of a large new issue calendar driven by fears of tax regime changes in 2025 and their potential impact on municipal issuers' access to tax-exempt financing may present headwinds.
- Bloomberg U.S. Municipal Taxable Bonds Index spreads continue to tighten on the back of light supply. At the index level, taxable spreads tightened 18 basis points during 2024, resulting in a 1.6 percent total return through year end.

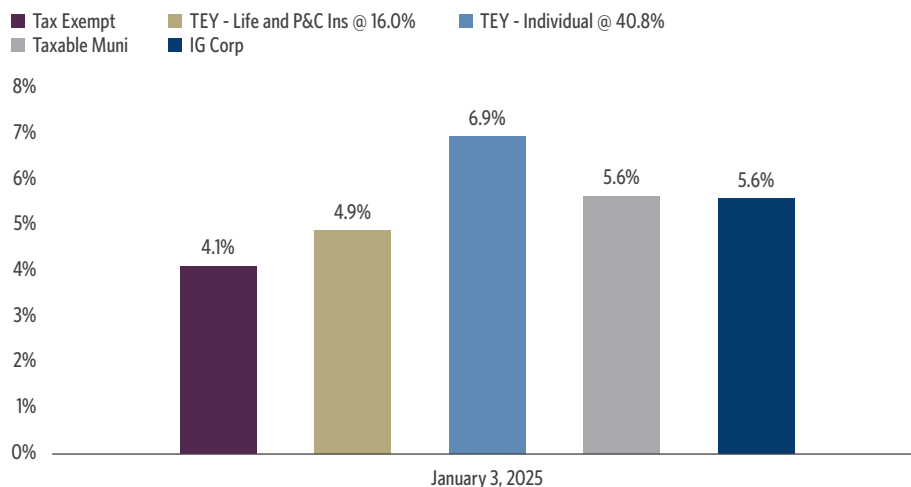
Investment Themes

- At current ratios and spreads, we prefer taxables for institutional investors due to tight valuations in exempts. For retail investors, we caution against focusing solely on the high taxable equivalent yields as current valuations provide limited buffer against a market dislocation.
- Traditional high quality sectors such as general obligation property tax bonds and utilities do not offer attractive risk/reward characteristics at current muni/Treasury ratios. Instead, we are looking for solid credits within higher beta sectors, including affordable housing, charter schools, and continuing care retirement communities.

By Allen Li and Michael Park

Taxable municipal spreads continue to tighten on the back of light supply. At the index level, taxable spreads tightened 18 basis points during 2024, resulting in a 1.6 percent total return through year end.

Taxable Muni Yields Have Kept Pace with IG Corporates



Source: Guggenheim Investments, Bloomberg, TM3. Data as of 1.3.2025.

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