

U.S. Municipal Bond Market

Municipals Still Investable in Front of the Fed's June 2022 Announcement

- We still believe tax-exempt and taxable U.S. municipal bonds are investable in front of the Fed's June 2022 policy announcement.
- Tax-exempt and taxable municipal yields, relative value indicators, and credit spreads are all still very attractive compared to historical pricing and some other fixed income options.
- Investors should concentrate on creating or adding to positions with high-quality (Aa3/AA- rated or above) general obligation and revenue bonds. It will likely make sense for investors to continue to add to these positions throughout the rest of 2022.
- Investors can and should be selective in the current environment. We do not think it is necessary for investors to take unnecessary risk by purchasing municipal bonds with heightened pension liabilities or debt from issuers who are not appropriately managing their pension risk.

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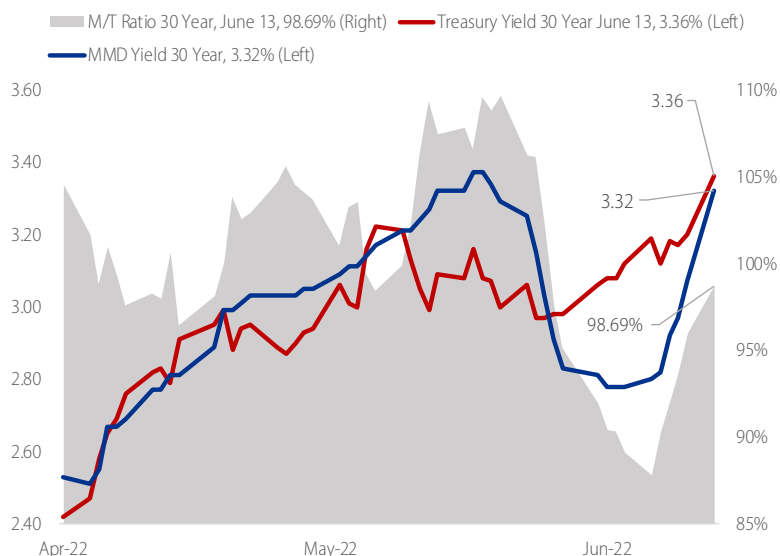
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Plenty of Financial Market and Economic Uncertainty

Worrying inflation-related and other economic data caused markets to dive in recent days. Bond yields climbed again Tuesday, the day before the Fed is scheduled to announce its latest policy adjustment. Monday morning it seemed anything other than a 50 basis point hike by the Fed would have been a surprise, because that is what the Central Bank said was likely before its quiet period began. Now, that the consensus believes the Fed is more likely to raise its target rate by 75 basis points we believe the markets would be more surprised by a move that is not at least 75 basis points. It is also possible that the Fed raises a total of 275 basis points by the time we get to their

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Municipal Yields and Relative Value Indicators are Attractive Still



Sources: Refinitiv and HilltopSecurities.

December 2022 meeting. We could see a 75 basis point increase in both June and July, 50 basis point increases in both September and November and then a final 25 basis point hike in December. We still like municipals as a fixed income option whether we see a 50 basis point or 75 basis point increase tomorrow.

We Still Like Tax-Exempt and Taxable Municipals Ahead of the Fed Decision

Back in the middle of May we wrote [Municipal Bonds are an Exceedingly Appealing Fixed Income Opportunity Right Now](#) (May 11). Many of the same reasons of why we liked municipals in May still exist today. We think that tax-exempt and taxable municipals are still investable right now, even though there is an important Fed meeting splitting this week in two scheduled for Wednesday.

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Yields are Still Attractive

Fixed income investors, especially those prioritizing asset-preservation, should continue to add to tax-exempt (and taxable) municipal positions regularly through the Fed activity in 2022. Yields have risen significantly since the beginning of the year, you can see in the accompanying chart that the AAA Municipal Market Data (MMD) benchmark yield has risen back to a 3.32%. For some time this year we have been using the "A" rated hospital yield in Refinitiv's basket as a indicator of when retail interest would exist for municipals. The market blew past the 3.00% indicator we had for the 30-year (A rated) hospital weeks ago and settled at a 4.16% again on Monday June 13.

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Relative Value Indicators are Still Attractive

An attractive feature of where municipals were in May had to do with the appealing Municipal to Treasury ratios we were more regularly seeing. We highlighted that both the 10-Year and 30-Year M/T Ratios were above their 10-year averages of 92% (for the 10-Year M/T Ratio) and 99% (for the 30-Year M/T Ratio.) This traditional relative value indicator has fallen slightly in appeal in the last month, but the 10-year is still partially attractive at 84%, or just under its 10-year average. The 30-Year M/T Ratio is also attractive at 99%, just on top of its 10-year average. We would also not be surprised to see the M/T Ratios improve if market volatility continues.

Taxable Municipals

Many municipal bonds are tax-exempt, but some are not. We have seen an increase of taxable issuance in 2020 and 2021 as public finance entities utilized them for refunding transactions. Taxable municipals may have a broader appeal to some investors because of their tax status. They should also have an increasingly broader appeal because of spread widening we have been seeing in recent weeks and months. Taxable spreads fell slightly at the end of May but they are still very attractive. The credit spread between a AA taxable municipal (30-year) and the 30-year Treasury is now 139 basis points, compared to only 84 basis points on Feb. 11. The AA taxable municipal yield (30-year) rose to a 4.75% as of June 13 from a 3.10% in February.

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Wider Municipal Credit Spreads Almost Across the Board

Credit spreads for municipals have been increasing almost across the board for general obligation (GO) and revenue bonds since the beginning of the year. They have peaked for the year so far to begin the week of June 13. AA GO credit spreads to the AAA benchmark rose to 41 basis points yesterday. That difference was only 21 basis points to begin the year. While there is the potential for spreads to widen further especially if economic conditions worsen and liquidity deteriorates, this would be an attractive entry point in most circumstances for investors creating or adding to positions.

We wrote in May that we were expecting strong municipal credit quality and that public finance upgrades are going to outpace upgrades in 2022. We still expect both of these statements to be true.

Credit Outlook

Our credit outlook for the U.S. municipal bond market remains unchanged. We wrote in May that we were expecting strong municipal credit quality and that public finance upgrades are going to outpace upgrades in 2022. We still expect both of these statements to be true.

Recent HilltopSecurities Municipal Commentary

- [REVISED: Our 2022 Municipal Bond Issuance Forecast](#), June 13, 2022
- [School District Credit Quality is Strong, Former Mayor Bloomberg is Overreaching](#), June 2, 2022
- [Voters Want Normalcy – This is Not It – More Political Change is Likely](#), May 31, 2022
- [Municipal Bonds are an Exceedingly Appealing Fixed Income Opportunity Right Now](#), May 11, 2022

Readers may view all of the HilltopSecurities Municipal Commentary [here](#).

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