

U.S. Municipal Bond Market

Market Volatility Equals What Could Be The Best Opportunity of the Year for Municipal Investors

- Market volatility, and observers' focus on the Fed's dependence upon data is now offering what could be the best opportunity for a new, or additional entry into the municipal bond market for 2024.
- Fixed income and tax-exempt yields surprisingly rose, and they remain elevated (and tax-exempts are still generationally attractive) but likely may not stay elevated for very long.
- Flows into municipal mutual funds have been positive for a record (in 2024) 15 weeks. But they are likely to soften for the rest of this year.

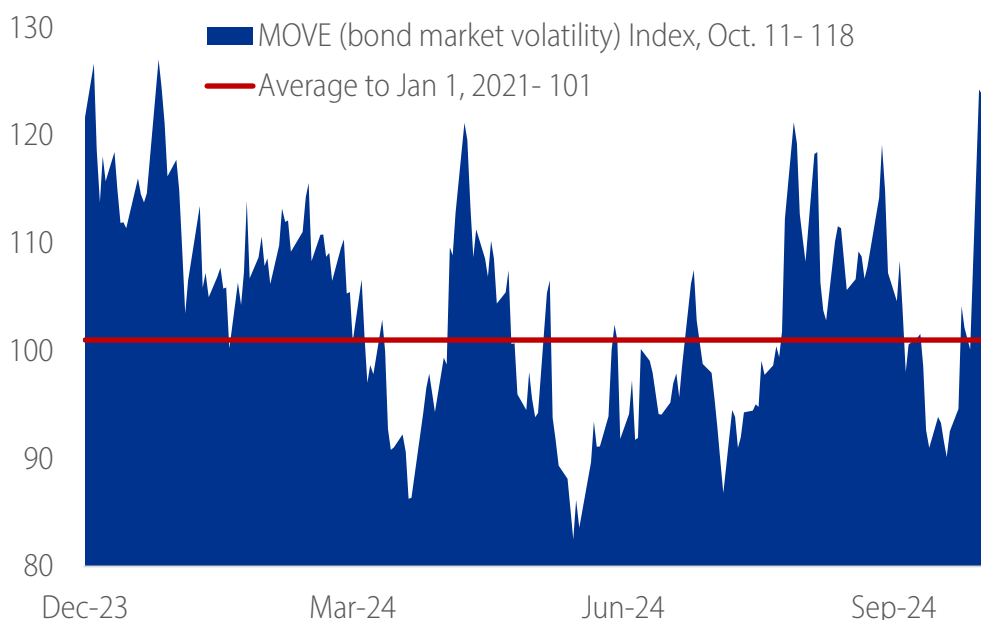
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Fed Lowered Target Rate, Yet Market Volatility Offers Opportunity

The U.S. Federal Reserve advised: "The time has come for policy to adjust," during Fed Reserve Chairman Jerome Powell's remarks from Jackson Hole, WY. The Fed then follow-up by going big, and lowered its target rate 50 basis points. Yet, market volatility, and observers' focus on the Fed's dependence upon data is now offering what could be the best opportunity for a new, or additional entry into the municipal bond market for 2024. Results from the ICE/BofA MOVE Index came in at a near peak for the year at the beginning of last week, reflecting the results from the Oct. 4 blowout jobs report. Fixed income and tax-exempt yields surprisingly jumped and remain elevated (and tax-exempts are still generationally attractive) but likely may not stay elevated for very long.

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Bond Market Volatility Was Near its 2024 Peak Recently, Marking an Opportunity



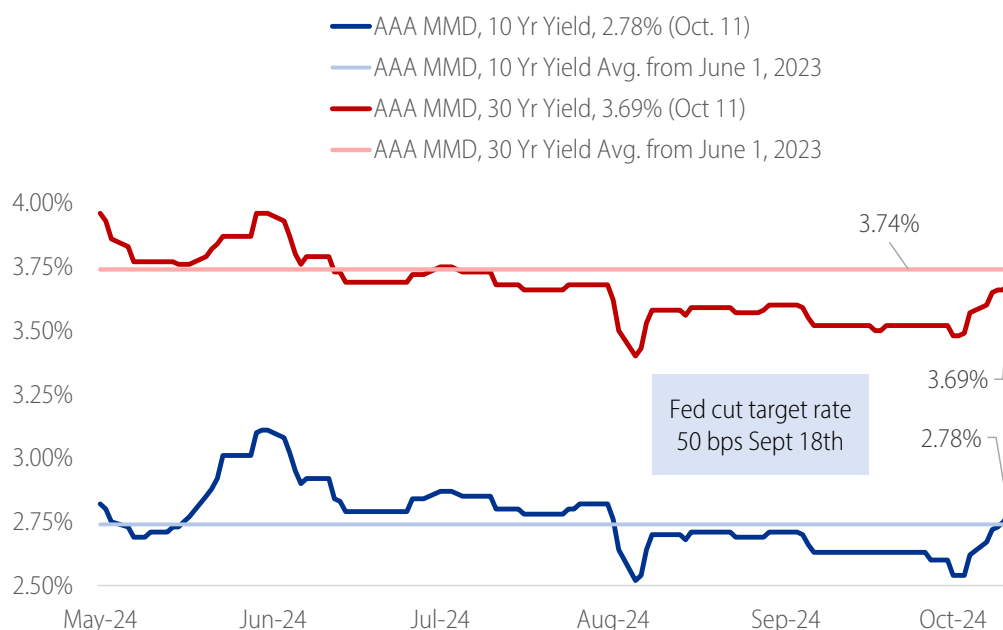
Source: The ICE, BofA MOVE Index data is from Bloomberg and HilltopSecurities.

Investors are Learning About the Tax-Exempt Bond Secret We Wrote About

We wrote tax-exempt bonds could be the best kept secret in the fixed income investing landscape this summer. Investors are uncovering the secret as illustrated by the \$1.9 billion that flowed into municipal funds for the week ending Oct. 3 per Lipper data. Demand has slipped, however. Flows remain positive but they fell. Tax-exempt yields on the other hand have increased substantially in the month of October, offering municipal investors one of the best entry points of the year. It is the market's read of the Fed's dependence on data, as we wrote above, that is the key reason for this. Municipal yields have been generationally attractive and are even more so now.

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Tax-Exempt Yields Have Risen Since the Fed Lowered its Target Rate on Sept. 18



Municipal yields have been generationally attractive and are even more so now.

Source: Refinitiv/TM3 and HilltopSecurities.

The ten-year Municipal Market Data (MMD) municipal AAA benchmark rose 15 basis points, to 2.78% from a 2.63% since the Fed lowered its target rate on Sept. 18. Meanwhile the thirty-year MMD AAA benchmark jumped 19 basis points, to 3.69% from a 3.50% since Sept. 18. We should not spend too much time overthinking why this happened, because the Fed is still likely to continue to move its target rate lower during the rest of 2024 and into 2025. What is likely is that the market (most markets, not just tax-exempts) got ahead of itself because of its read on the macro-economic landscape. Data coming in will likely continue to be volatile in coming months, maybe even in coming quarters. The volatility that occurred at the beginning of October could offer municipal investors the best market opportunity of the year, so far.

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Read on Supply for October and the Rest of 2024

Primary market supply of municipal issuance should remain very strong this week. We expect to see about \$14 billion price as issuers rush to get bonds sold before the month of November. We still believe overall our revised forecast of \$480 billion makes sense, but we also would not be surprised at this point if we see a record amount of issuance for 2024. This is also setting the stage for a potentially record breaking 2025 in terms of issuance as well as we have noted before.

Demand Side– Flows into Municipal Mutual Funds & Relative Value

All year we have been trying to anticipate how flows into municipal mutual funds could shape up. We expected that flows into municipal funds would accelerate when the Fed began to lower the target Fed Funds rate. This ever so briefly did occur as we noted when we saw \$1.9 billion deposited into funds as of the week ending Oct. 3. Market volatility saw flows reduced to only \$419k the following week—but they were still positive.

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From a big-picture perspective, municipal fund flows have been positive for the last 15 consecutive weeks through Oct. 10, averaging about \$840k per week. During a similar period in 2021, flows averaged \$1.3 billion per week, but then fell to about \$800k per week for the last 12 weeks of 2021. It's important to recognize this weakening trend. The potential for flows to weaken for the rest of this year is very high because of seasonality and because of the above-mentioned market volatility. However, when volatility lifts and a higher level of certainty returns, it could be too late for some investors to find the bonds they prefer. At that point, institutions may be able to deploy their billions of investment dollars, effectively crowding out the selective opportunities individual investors have enjoyed for most of 2024.

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Relative value indicators such as municipal to Treasury (M/T) ratios have improved slightly recently, but not to levels that are likely to wake-up cross-over buyer interest.

Recent HilltopSecurities Municipal Commentary

- Higher Education in Crisis, Systemic Pressures Buck the Golden Age Trend, September 25, 2024
- Our 2024 Election Preview: We Could See an Unprecedented Threat to U.S. Municipals from Potential Tax Policy Changes, September 11, 2024
- Revised Again: Strong GDP Growth Boosts Our 2024 Issuance Forecast to \$480 Billion, September 5, 2024
- Inflation Part II, September 4, 2024
- The Time is Now, August 27, 2024
- Bonds Are Back, August 15, 2024

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

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