HilltopSecurities

U.S. Municipal Bond Market

Liberation Day Impact: Top Municipal Opportunity Since 2023 Amid Macro, Tariff Uncertainty

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- **Escalation of Trade War:** President Trump's Liberation Day announcement introduced new tariffs, shaking the global economic order and U.S. financial markets, increasing recession fears.
- **Trade Policy Uncertainty:** The Trade Policy Uncertainty Index has risen sharply, reflecting heightened market concerns, with potential impacts from Liberation Day yet to be fully realized.
- **Investor Behavior:** Investors are adopting a risk-off stance, shifting towards safer assets amid market volatility and macro uncertainty, creating potential opportunities in municipal bonds.
- **Municipal Bond Yields:** AAA MMD yields surged, reaching a one-day increase not seen since the COVID crisis, presenting attractive investment opportunities despite uncertainty.
- **Tax-Exempt Status of Existing Bonds:** Despite ongoing policy uncertainty, we believe existing municipal bonds are likely to retain their tax-exempt status, as eliminating it could undermine investor trust and market stability.

Impact of President Trump's Liberation Day

President Donald Trump rattled the global economic order and U.S. financial markets by unveiling a major escalation in his trade war with new tariffs last week on what he referred to as, Liberation Day. Many economists have increased the likelihood of a recession occurring in 2025, with some even suggesting the chances are greater than a coin flip. This is largely due to the potential negative impact of President Trump's new trade and tariff policies. The head of BlackRock stated on Monday that some CEOs believe the U.S. is already in a recession. Equity investors have been rattled, and indices were flirting with bear market territory to being this week. The outlook for the week is uncertain, with word coming in that countries want to negotiate with the U.S., there is hope victory can quickly be announced or policy quickly paused or shifted.

Despite ongoing policy uncertainty, we believe existing municipal bonds are likely to retain their tax-exempt status, as eliminating it could undermine investor trust and market stability.

The risk-off stance many investors gravitated toward means they are beginning to avoid investments with risk. Many are turning to more stable choices or increasing levels

Summary of Select Daily Changes to MMD

Day	Date & Change to previous trading day	MMD AAA Yield 1 Year	10 Year	30 Year
Thursday	APRIL 3rd	2.51%	3.09%	4.07%
Friday	APRIL 4th	2.43%	2.97%	3.99%
	Change to previous trading day	-0.08%	-0.12%	-0.08%
Monday	APRIL 7th	2.73%	3.32%	4.34%
	Change to previous trading day	0.30%	0.35%	0.35%

Source: LSEG TM3 and HilltopSecurities.

of cash to protect themselves from market volatility, global trade policy and macro uncertainty. However, this is now setting up to be what could be the best municipal opportunity we have seen in the last 18 months, or perhaps since the end of 2023.

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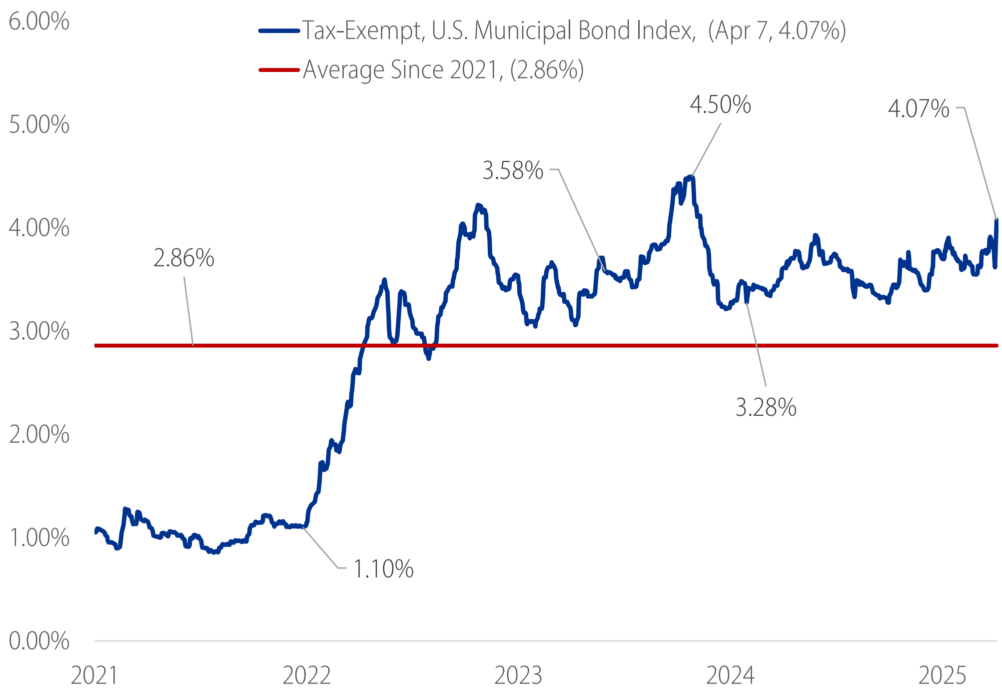
On Monday AAA Municipal Market Data (MMD) yields jumped anywhere from 30 to 35 basis points compared to Friday's levels. We must go back to the beginning of the COVID crisis to find a time when the market was similarly trying to find its footing. We have not seen absolute yields such as this since the end of 2023 for maturities on the long end and the summer of 2024 for maturities closer to the 10 year. The Bloomberg Municipal Bond Index (shown on the next page) jumped 46 basis points to a 4.07% (from a 3.62%) on Monday April 7 compared to Friday April 4.

Municipal bonds are not just investable here, we are seeing very attractive municipal yields despite the whip-saw effect the market has experienced in recent trading days. Municipal yields are peaking near the higher end of the generationally attractive levels we have been tracking but this may not be the case if economic growth slows, if the FOMC resumes their easing progress, or if the FOMC lowers their interest rate target to combat broader economic deterioration or labor market softening.

Municipal Yields Jumped to Most Attractive Levels Since 2023



Source: Bloomberg and HilltopSecurities.

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Trade Policy Uncertainty

Policy uncertainty continues to rise. In our March 17 report Navigating the Trump Trade War, we noted that this policy uncertainty skyrocketed to an entirely new level. The Trade Policy Uncertainty Index numbers we present here do not yet account for the impact from Liberation Day. That impact will be substantial if the equity market reaction is any indicator.

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Monday morning CNBC aired an 'unconfirmed' report of a potential 90-day tariff pause, that report ended up being false. However, market participants reacted briefly to the false report. This shows how quickly investors can digest news in the current environment.

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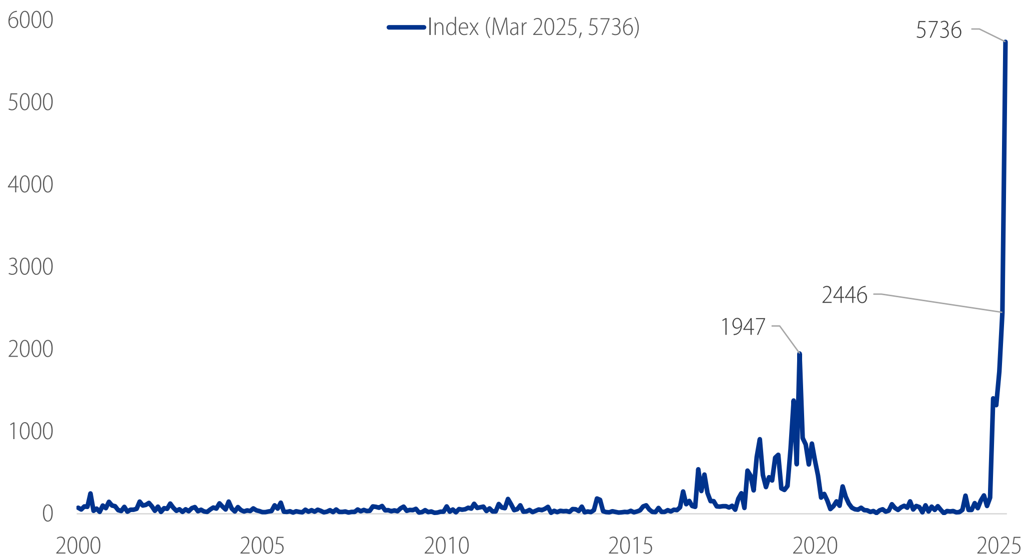
In prepared comments on Friday Fed Chairman Powell said he expects the higher than expected tariffs to increase inflation, and slow growth. Some speculated over the weekend the Fed may make an emergency rate cut, as it had under similar equity market downturns during the World Financial Crisis and COVID Crisis. However, we think such a move by the Fed is unlikely unless a systemic market risk develops.

Trade Policy Uncertainty Index Continues its March Higher



Source: Scott Baker, Nick Bloom, Stephen Davis and HilltopSecurities.

Message to Investors About Existing Bonds Remains the Same

We updated investors about the potential timing for 2025 tax policy and the tax-exemption threat last week in The Greatest Threat Remains Imminent, Timing Uncertain. In last week's report we addressed what could happen to the tax status of existing bonds if the entire or a portion of the municipal bond tax-exemption is eliminated, but we will reiterate that unchanged (so far) opinion here. We are still regularly getting questions about this topic unsurprisingly.

We still believe it is more likely that existing bonds will retain their tax-exempt status.

We still believe it is more likely that existing bonds will retain their tax-exempt status. We have not seen many, if any, reputable proposals suggesting the elimination of the tax-exempt status on existing bonds. Federal officials (and especially their advisers) generally understand the importance of maintaining investor trust. Eliminating the tax-exempt status on existing bonds would negatively impact many retired fixed-income investors, potentially undermine investor trust and result in market instability.

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However, as we witness how the current administration has revealed different policies, we are increasingly rethinking that stability may not be among this administration's goals. However, for now, our base case scenario is that existing bonds will keep their tax-exempt status if the tax-exemption or parts of it are eliminated.

Recent HilltopSecurities Municipal Commentary

- The Greatest Tax-Exemption Threat Remains Imminent, Timing Uncertain, April 1, 2025
- Improvement in America's Infrastructure Endangered by the Threat to the Tax-Exemption, March 25, 2025
- Navigating the Trump Trade War: Strategies for Municipal Investors Amid Macroeconomic Uncertainty, March 17, 2025
- While Public Finance Sleeps, Feb. 12, 2025
- The Municipal Market in 2025, Hilltop's Sector Credit Outlooks, Jan. 30, 2025

Readers may view all of the HilltopSecurities Municipal Commentary here.

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