

U.S. Municipal Bond Market

Rate Cut Expectations Surge, Could Mean Renewed Momentum for Municipals

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- The expectation of lower rates tends to drive demand and with supply still strong December could be a month of renewed momentum for municipal buyers.

*Tom Kozlik**Head of Public Policy and**Municipal Strategy**214.859.9439**tom.kozlik@hilltopsecurities.com*

The Market's Appetite for Municipal Bonds Is Likely to Pick Up

The tone of the market-conversation changed quickly. Just a week ago investors were debating whether the Federal Reserve would hold steady into the new year. Now the odds of a Dec. 10 rate cut are not just more than likely. A cut is now expected. Fed futures are pricing in close to 100% probability and the announcement from San Francisco Fed President Mary Daly supporting a cut only added fuel to the fire at the beginning of last week.

Think about that for a moment. Just about two weeks ago many were wondering if the Fed would pause. Now we are back to expecting another cut and soon. That means the market's appetite for municipal bonds is likely to pick up.

After a shaky start to November equity markets found their footing and rallied into the close of November. The rebound was more than just timing or based on technical indicators. The rebound reflected growing confidence that lower rates are on the horizon. Investors are leaning into the idea that the Fed will act decisively to support growth as signs of macro-economic and labor market cooling become harder to ignore.

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U.S. municipal bond market yields rose slightly as November ended, a modest move considering the broader rate volatility. Heavy primary municipal market supply from October and November is still saturating the secondary market, which is good news. If history is any guide flows into municipal mutual funds tend to pick up when rate cuts are expected, and December looks like it will fit that pattern. Strong demand is likely and fortunately dealers will have the inventory to meet it.

The results included in the November Beige Book did not make headlines, but they deserved more attention. It reported slight labor market weakness across many of the Reserve Districts and we think more softness is coming down the pike. That possibly is part of why the Fed may be leaning toward easing again. The economy is not in crisis, but the cracks are visible, and policymakers are likely seeing them. Market expectations are moving back to where they were just weeks ago expecting an imminent rate cut. For municipal investors that could mean opportunity. The expectation of lower rates tends to drive demand and with supply still strong December could be a month of renewed momentum for municipal buyers.

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