Patience remains a virtue for municipal investors

BlackRock.

Municipal April update

- Municipal bonds posted negative total returns but outperformed comparable Treasuries in April.
- The large and diverse new issue slate was well absorbed at higher nominal yields.
- We remain cautious and selective amid elevated macro uncertainty and rich valuations.



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Market overview

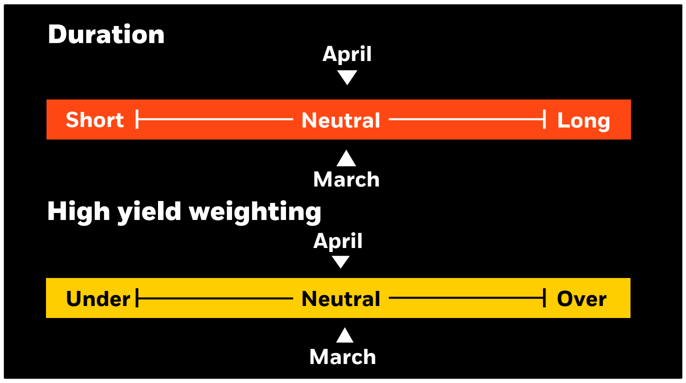
Municipal bonds posted negative performance in April. Interest rates rose and pressured fixed income assets as stronger-than-expected employment and inflation data prompted a more hawkish tone from the Federal Reserve, further reducing expectations for monetary policy easing in 2024. Municipals displayed their more defensive nature and outperformed comparable Treasuries. The S&P Municipal Bond Index returned -1.07%, bringing the year-to-date total return to -1.16%. Shorter-duration bonds and the high yield sector performed best.

Issuance swelled to $45 billion in April, 29% above the five-year average, bringing the year-to-date total to $143 billion. Luckily, the increase was well telegraphed, and investors welcomed the ability to buy diverse credits in size at higher nominal yields. Consequently, deals were oversubscribed 3.8 times on average, only slightly below the year-to-date average of 4.3 times. At the same time, fund flows turned more mixed but were dragged down by temporary, seasonal tax-time redemptions.

Admittedly, the patient and cautious approach that we took at the start of the year has extended longer than originally predicted. However, given that the macro backdrop has become less supportive, and municipal valuations remain rich, we think that caution continues to be warranted. Looking ahead, municipals are expected to benefit from a favorable, seasonal tailwind during the summer months, but continued above-average issuance will likely keep it subdued versus recent history. As a result, we maintain elevated cash balances and await more attractive opportunities to deploy capital, particularly in the primary market.

Strategy insights

We favor a neutral duration posture overall. We continue to advocate a barbell yield curve strategy, pairing front-end exposure with an increased allocation to the 15-20-year part of the curve. We prefer single-A rated credits but think high yield offers an attractive risk-reward opportunity, given favorable structures and the ability to generate alpha through security selection.



Overweight

- States that primarily rely on consumption taxes
- Essential-service revenue bonds
- Flagship universities
- Select issuers in the high yield space

Underweight

- States overreliant on personal income taxes, especially California
- Speculative projects with weak sponsorship, unproven technology, or unsound feasibility studies
- Senior living and long-term care facilities
- Lower-rated private universities
- Stand-alone and rural health providers

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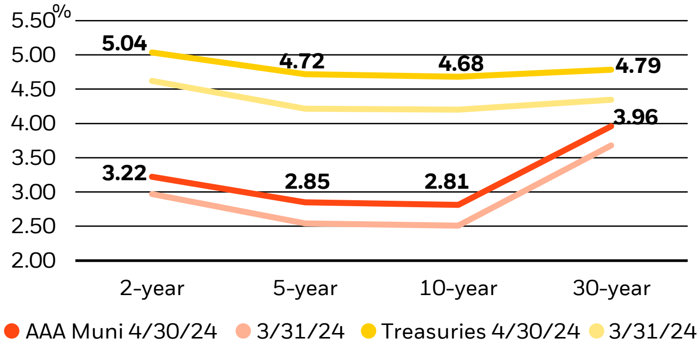
Credit headlines

After several months of limited supply, municipal bond investors welcomed the opportunity to add yield to their portfolios with two multi-billion dollar deals in April. One of these deals involved Brightline, a privately owned passenger train in Florida that operates segments between Miami and Orlando. Brightline refinanced $4 billion of non-rated, high yield debt with ~$4.6 billion of new capital. The structure of this new deal appealed to a wide spectrum of investors with $2.2 billion of first lien BBB- (the lowest investment grade rating), tax-exempt bonds (half of which were insured), $1.3 billion of second lien, B-rated, high yield, taxable corporate bonds, and $950 million third lien, unrated, tax-exempt bonds. More than 50 accounts competed for the investment grade portion, and subscription levels were over two times. The uninsured investment grade securities offered a 5.5% coupon with a 5.15% yield. The maximum yield, insured long bonds carried a 5.25% coupon, yielding 4.65%. The unrated tax-exempt bonds, which were issued by a subordinate holding company responsible for the planned extension to the Tampa segment, priced with an attractive 12% yield.

Novant Health (rated A1/A+/AA-), a health system in the Southeast, issued $1.9 billion of bonds to fund the purchase of three not-for-profit hospitals in South Carolina from Tenet Healthcare, a national health company. The purchase allows Novant to expand its Coastal Carolinas' patient population, offer specialized medical services, and strengthen its position as a regional healthcare provider. The bond issuance drew $10 billion in orders, with investors showing interest across all maturities. Investors showed preference for the long maturities, where the highest yield was 4.68% for the 4.5% coupon, due in 2054. The deal was repriced to lower yields, showing the market's strong belief in Novant Health's financial future.

Municipal and Treasury yield movements



Sources: BlackRock, Bloomberg.

Municipal performance

	Apr'24	YTD
S&P Municipal Bond Index	**-1.07%**	**-1.16%**
Long maturities (20+ yrs.)	-1.59%	-1.62%
Intermediate maturities (3-15 yrs.)	-1.08%	-1.32%
Short maturities (6 mos.-4 yrs.)	-0.19%	-0.13%
High yield	-1.14%	1.34%
High yield (ex-Puerto Rico)	-1.15%	1.39%
General obligation (GO) bonds	-1.16%	-1.57%
California	-1.08%	-1.18%
New Jersey	-1.16%	-1.26%
New York	-1.11%	-1.43%
Pennsylvania	-1.01%	-1.01%
Puerto Rico	-0.98%	0.98%

Sources: S&P Indexes.

Investment involves risk. *The two main risks related to fixed income investing are interest rate risk and credit risk. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and interest payments. There may be less information available on the financial condition of issuers of municipal securities than for public corporations. The market for municipal bonds may be less liquid than for taxable bonds. A portion of the income from tax-exempt bonds may be taxable. Some investors may be subject to Alternative Minimum Tax (AMT). Capital gains distributions, if any, are taxable.* ***Index performance is shown for illustrative purposes only. You cannot invest directly in an index. Past performance is no guarantee of future results.***

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