Trade war brings April showers

BlackRock.

Municipal March update

- Higher-than-anticipated tariff increases weighed heavily on municipal market sentiment.
- Seasonal supply-and-demand dynamics were further challenged by outflows.
- Most municipals are based upon domestic revenue that is less impacted by tariffs.



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Market overview

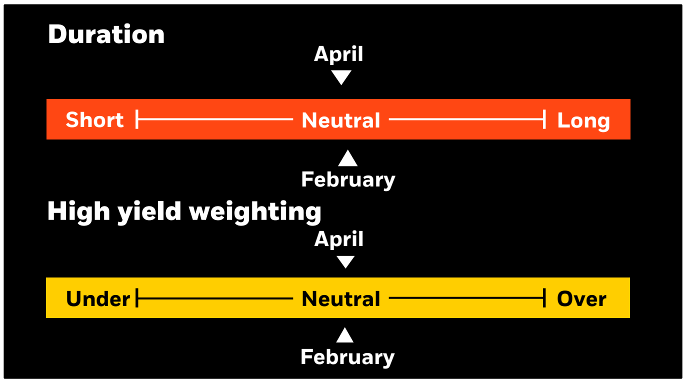
Less favorable seasonal technicals, increased focus on municipal-specific policy risks, and severe volatility spurred by higher-than-anticipated tariff increases weighed heavily on sentiment and resulted in deeply negative total returns and significant underperformance versus Treasuries in March and early April. The S&P Municipal Bond Index returned -1.59% in March and -3.26% through the first nine days in April, bringing the year-to-date total return to -3.49%. Not surprisingly, the front end of the yield curve, AA rated credits, and prerefunded bonds performed best. However, with the recent announcement of a 90-day pause on all reciprocal tariffs except those imposed on China, risk markets have stabilized, and we anticipate a rebound in municipal bonds in the days ahead.

Supply-and-demand dynamics remain a headwind. Demand waned amid heightened uncertainty and tax loss harvesting, with outflows accelerating amid the market turmoil. At the same time, the transition from net negative to net positive supply combined with reduced liquidity from lighter dealer participation to place added pressure on the market. Although several deals were postponed in early April, we think the new issue market will normalize, and issuers will continue to front-run tax changes.

We remain patient but are taking advantage of higher yields by slowly putting money to work with a focus on investment grade bonds. In our view, municipal fundamentals have not materially changed and remain strong. Given that a high percentage of the municipal market is based upon domestic revenue, it is less impacted by tariffs than other markets. Thus, we think municipal bonds should provide ballast to a well-diversified portfolio.

Strategy insights

We are operating with a neutral duration posture and are focused on sustaining sufficient cash balances to meet potential redemptions. We favor an up-in-quality bias, given a more attractive opportunity set following the recent market correction. We maintain a barbell curve strategy, pairing front-end exposure with an increased allocation to the 20-year part of the curve.



Overweight

- Suburban governments and school districts
- Prepaid gas
- Housing bonds
- Select issuers in the high yield space
- National and large regional health systems

Underweight

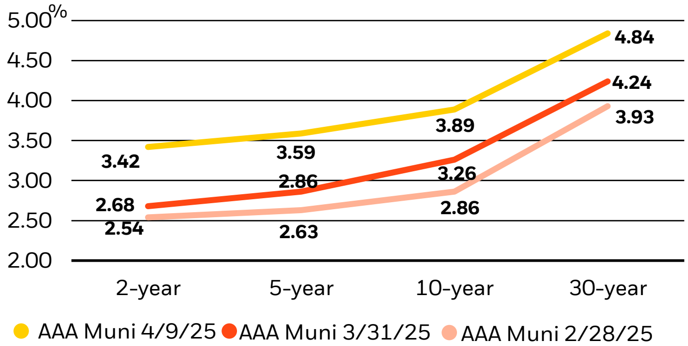
- Speculative projects with weak sponsorship, unproven technology, or unsound feasibility studies
- Rural, exurban, and urban safety net hospitals
- Senior living and long-term care facilities
- Small private colleges

Credit headlines

The Trump administration has introduced significant policy changes, including extensive spending cuts, deregulation, higher tariffs, constraints on immigration, and a renewed emphasis on domestic energy production. They have also proposed extending federal tax cuts, which may involve measures that cap or eliminate the municipal exemption, limit the issuance of private activity bonds, and/or significantly increase taxes on university endowment net income. These changes could adversely affect market participants, leading to downward pressure on credit quality and widening credit spreads in most segments of the municipal market. Additionally, spending cuts could include reductions to Medicaid, disaster relief, research grants, and K-12 education funding, impacting large sectors such as states, local governments, school districts, hospitals, and higher education.

Although the likelihood of changing the tax exemption for municipal bonds is low, its potential removal would drive borrowing costs significantly higher for issuers responsible for building national infrastructure. Since most grants to state and local entities are mandatory and require Congress to amend existing laws, and most discretionary grants benefit from bipartisan support, it is likely that the proposed changes will be subject to compromise. However, if comprehensive changes are enacted, they will negatively impact the municipal bond market. We anticipate that the effects would likely result in minor downgrades in credit agency ratings rather than major shifts into lower rating categories. Most municipal issuers are in excellent fiscal health with strong liquidity and are operating with structurally balanced budgets. Additionally, most municipal issuers are benefiting from historically low debt service costs and improved pension funding levels. Overall, while federal policy changes will create challenges, they also present opportunities for astute investors to secure compelling high-quality tax-exempt yields for the years ahead.

Municipal yield movements



Sources: BlackRock, Bloomberg.

Municipal performance

	Apr'25*	YTD*
S&P Municipal Bond Index	**-3.26%**	**-3.49%**
Long maturities (20+ yrs.)	-5.37%	-6.61%
Intermediate maturities (3-15 yrs.)	-2.72%	-2.54%
Short maturities (6 mos.-4 yrs.)	-0.95%	0.02%
High yield	-4.74%	-4.32%
High yield (ex-Puerto Rico)	-4.53%	-4.06%
General obligation (GO) bonds	-3.12%	-3.39%
California	-3.30%	-3.74%
New Jersey	-3.03%	-3.40%
New York	-3.45%	-4.01%
Pennsylvania	-3.23%	-3.37%
Puerto Rico	-6.01%	-5.86%

Sources: S&P Indexes. *As of 4/9/2025.

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