ALLIANCEBERNSTEIN®

Weekly Market Commentary

The Week in Muniland

January 27, 2025

Keep It Coming

Key Takeaways

1. **The municipal market delivered strong relative and absolute performance last week.**
2. **The year 2025 is likely to be filled with both ups and downs. We highlight ways investors can navigate the current environment.**
3. **With volatility likely to continue, flexible mandates are critical.**

The municipal market continued to recover from the bout of volatility at the beginning of the year, with market yields falling once again last week. For the week, two-, 10- and 30-year AAA municipal yields fell eight, eight and two basis points (bps), respectively, while US Treasury (UST) yields were largely flat across the curve. The Bloomberg Municipal Bond Index (Index) returned 0.26% last week—bringing it close to flat for the year—and is now down just 0.05% year to date.

- **Why it matters:** In addition to the positive absolute returns, the municipal market also clawed back some of its recent relative underperformance and outperformed USTs last week, with after-tax spreads tightening six to nine bps across the curve. Some of last week's outperformance can be attributable to strong demand, with investors adding north of $2 billion to the market last week, according to Lipper. Within that, longer-dated funds reaped the lion's share, with $1.5 billion flowing into longer-maturity funds. With the Federal Open Market Committee meeting this week, the calendar is looking relatively light, with only ~$7 billion expected to price. As a reminder, it is widely expected that the Fed will not cut rates this week. We expect the next Fed cut to come in June, with additional cuts in September and December.

As we have mentioned, 2025 is likely a year with some ups and downs. Our recent 2025 outlook blog, Battling Headwinds, Harnessing Tailwinds, highlights ways investors can navigate the potential crosswinds in the municipal bond market.

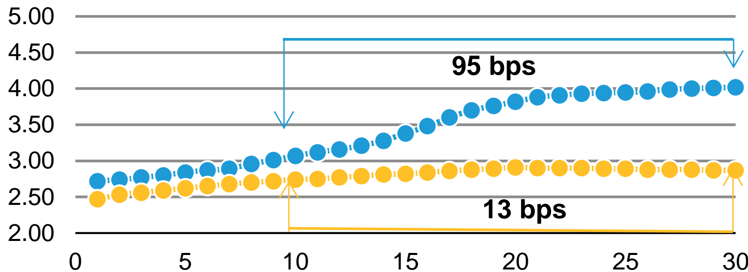
- **Why it matters:** The market is likely to face a significant amount of supply—around $450 billion—which can be a headwind if demand softens. That said, demand has been solid, with investors adding $47 billion last year and $2.6 billion so far this year, according to Lipper. Income was the primary driver of returns last year, and we believe that it will be the same this year. Fortunately for investors, with the Index yielding 3.76%, that starting point is particularly attractive. The Fed is likely to continue to cut rates, albeit more slowly than anticipated, which should result in the muni curve continuing to steepen as short-maturity yields fall. From a credit perspective, fundamentals are expected to remain strong, although tax revenues have fallen modestly from their record highs. For example, the median rainy-day cash balance now represents a record 14.4% of states' general funds. While credit spreads are relatively tight, current income levels and further demand for income portend credit's outperformance once again in 2025.

With volatility expected to continue this year, flexibility will be paramount to help generate stronger returns.

- **Why it matters:** Our research shows that historically, active municipal bond strategies have outperformed passive approaches 98% of the time over rolling three-year periods and 89% over two-year periods. Last year was no different, with active strategies generating stronger risk-adjusted returns compared to passive strategies. Volatile markets create dislocation, which creates opportunities for active management. Investors can adjust yield-curve positioning, credit opportunities and the relative value of high-grade munis versus USTs, to name a few. As shown in *Display 3,* this approach can not only boost overall portfolio income but also create additional opportunities for price appreciation and greater total return.

Displays of the Week: January 27, 2025

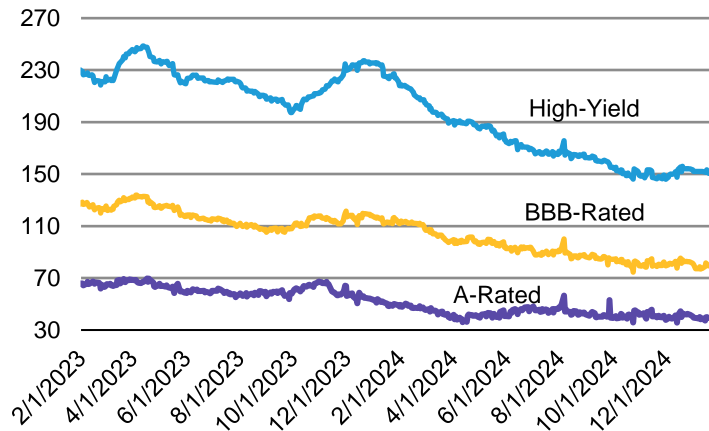
Display 1: Municipal Yield Curve vs. US Treasury Curve After Tax* (Percent)



While the shape of the yield curve has changed, a barbell maturity structure remains advantageous given the steepness at the long end of the curve.

*Tax rate used: 40.8%
As of January 24, 2025. Source: Municipal Market Data and AB

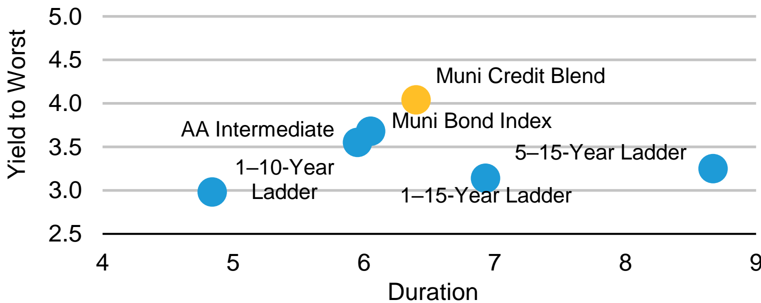
Display 2: Municipal Credit Spreads (Basis Points)



While credit spreads tightened significantly in 2024, credit offers a compelling income pickup versus higher-quality bonds.

As of January 24, 2025
Source: Bloomberg and AB

Display 3: Portfolio Construction for Today (Percent)

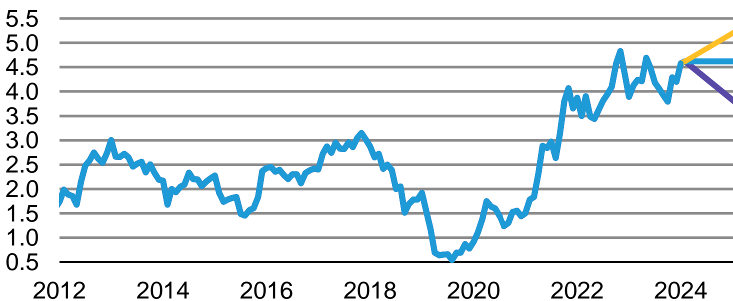


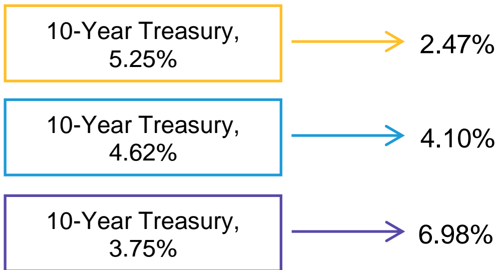
A thoughtful blend of high-grade and credit bonds along with a barbell maturity structure can add as much as 100 bps in yield to a portfolio.

Muni credit blend is a blend of Bloomberg muni indices: 55% high-grade, 30% A/BBB and 15% high-yield.
As of January 24, 2025. Source: Bloomberg and AB

Display 4: Expected 12-Month Municipal Returns Scenario Analysis

10-year US Treasury yield (percent)





Past performance and historical analysis do not guarantee future results.
Display reflects expected returns of the Bloomberg Municipal Bond Index under three scenarios: 10-year US Treasury yields rise to 5.25%, remain the same or decline to 3.75% over the next 12 months.
As of January 24, 2025. Source: Bloomberg and AB

The views expressed herein do not constitute research, investment advice or trade recommendations and do not necessarily represent the views of all AB portfolio-management teams. Views are subject to change over time.

A Word About Risk

Market Risk: The market values of the Portfolio's holdings rise and fall from day to day, so investments may lose value. **Interest-Rate Risk:** Fixed-income securities may lose value if interest rates rise or fall—long-term securities tend to rise and fall more than short-term securities. The values of mortgage-related and asset-backed securities are particularly sensitive to changes in interest rates due to prepayment risk. **Credit Risk:** A bond's credit rating reflects the issuer's ability to make timely payments of interest or principal—the lower the rating, the higher the risk of default. If the issuer's financial strength deteriorates, the issuer's rating may be lowered, and the bond's value may decline. **Inflation Risk:** Prices for goods and services tend to rise over time, which may erode the purchasing power of investments. **Foreign (Non-US) Risk:** Investing in non-US securities may be more volatile because of the political, regulatory, market and economic uncertainties associated with such securities. These risks are magnified in securities of emerging or developing markets. **Currency Risk:** If a non-US security's trading currency weakens versus the US dollar, its value may be negatively affected when translated back into US-dollar terms. **Diversification Risk:** Portfolios that hold a smaller number of securities may be more volatile than more diversified portfolios, since the gains or losses from each security will have a greater impact on the Portfolio's overall value. **Derivatives Risk:** Investments in derivative instruments such as options, futures, forwards or swaps can be riskier than traditional investments and may be more volatile, especially in a down market. **Leverage Risk:** Trying to enhance investment returns by borrowing money or using other leverage tools magnifies both gains and losses, resulting in greater volatility. **Municipal Market Risk:** Debt securities issued by state or local governments may be subject to special political, legal, economic and market factors that can have a significant effect on the Portfolio's yield or value. An investor cannot invest directly in an index. **Investment and Insurance Products:** Not FDIC insured I Not a bank deposit I Not insured by any federal government agency I No bank guarantee I May lose value

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