The Week in Muniland

February 10, 2025

Active Versus Passive, No Debate

Key Takeaways

1. **The municipal market continued to perform well, as demand remained strong.**
2. **Within the muni market, active management is the clear winner versus passive management.**
3. **The Fed will likely be on hold until June.**

The muni market had another positive week of performance, as demand continues to be strong. For the week, two-, 10- and 30-year AAA municipal yields fell 7, 6 and 4 basis points (bps), respectively. The Bloomberg Municipal Bond Index (Index) returned 0.43% last week and is now positive for the year, up 0.94%.

- **Why it matters:** The rally in the muni market this year has put its poor December performance (–1.46%) in the rearview mirror. Demand has been insatiable in the muni market this year, with combined mutual fund and exchange-traded fund flows—the best way to gauge investor demand—totaling $5.2 billion. Of that supply, 40% is flowing into high-yield strategies, while 62% is flowing into long-duration strategies. Investors are being drawn to these strategies given the steepness of the muni curve (*Display 1*) and the ongoing credit-spread compression (*Display 2*), which has led to outperformance. The Bloomberg Municipal High Yield Index has returned 1.33% year to date, outperforming the 1.00% AAA muni index return. From an entry-point perspective, munis look attractive. The yield to worst of the Index is 3.61%. When looking at month-end Index data going back to January 2014, there are only 13 month-end yields that were higher than today's—and all those periods occurred between 2022 and 2024.

In the muni market, there is no debating the benefits of active management versus passive. Nevertheless, this debate is ongoing.

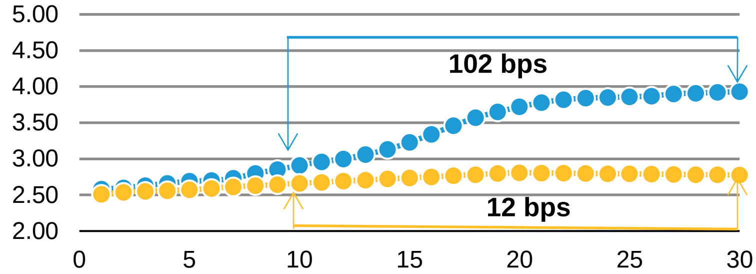
- **Why it matters:** Our research shows that historically, active municipal bond strategies have outperformed passive approaches 98% of the time over rolling three-year periods and 89% over two-year periods. Last year was no different, with active strategies generating stronger risk-adjusted returns 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 US Treasuries, 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. Given the current volatility in fixed income, this is not a time for an investor to stick their head in the sand and hope for the best. Read more in our recent blog Three Reasons Why It Pays to Be Active as a Muni Investor.

The labor market remained strong in January. While the headline gain of 143,000 jobs was slightly lower than expected, there were upward revisions of 100,000 to the previous two months.

- **Why it matters:** The data, taken as a whole, reflect a labor market that is in equilibrium. The run rate of hiring has averaged between 175,000 and 200,000 for a year; the unemployment rate has been between 3.9% and 4.2% for a year; the participation rate has been between 62.5% and 62.7% for more than a year; and the growth rate of wages has been at almost exactly 4.0% for a year. That is the very definition of a soft landing: the labor market has slowed to equilibrium without any disruption. That means that the labor market at this stage is neither pushing inflation up nor pulling it down. Given that, we do not believe that there are policy ramifications from these numbers. The Fed is comfortably on hold for the time being, and it would take a significant deviation from the existing trend for it to change its view while we all await details on trade and fiscal policy. We expect the next rate cut in June, primarily because we expect inflation to resume its downward trajectory in the next several months.

Displays of the Week: February 10, 2025

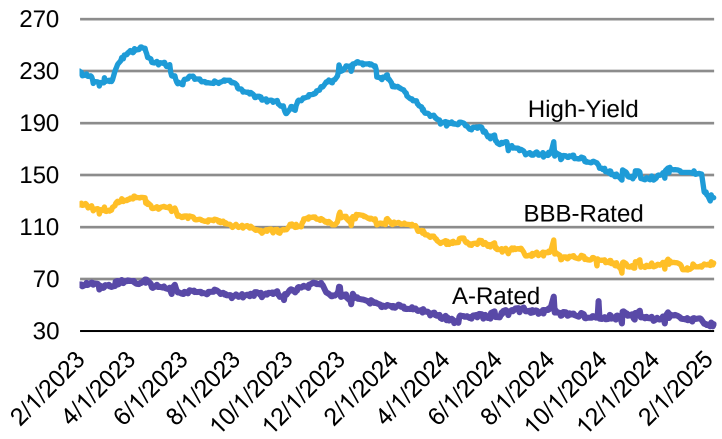
Display 1: Municipal Yield Curve vs. US Treasury Curve After Tax* (Percent)



While the shape of the muni yield curve is normalizing, a barbell maturity structure remains advantageous given the steepness at the long end of the curve.

*Tax rate used: 40.8%
As of February 7, 2025. Source: Municipal Market Data and AB

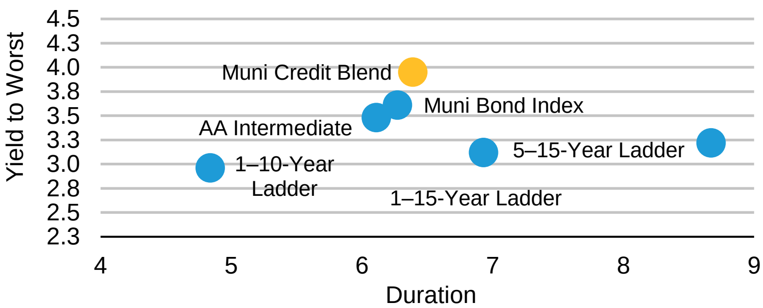
Display 2: Municipal Credit Spreads (Basis Points)



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

As of February 7, 2025
Source: Bloomberg and AB

Display 3: Portfolio Construction for Today (Percent)

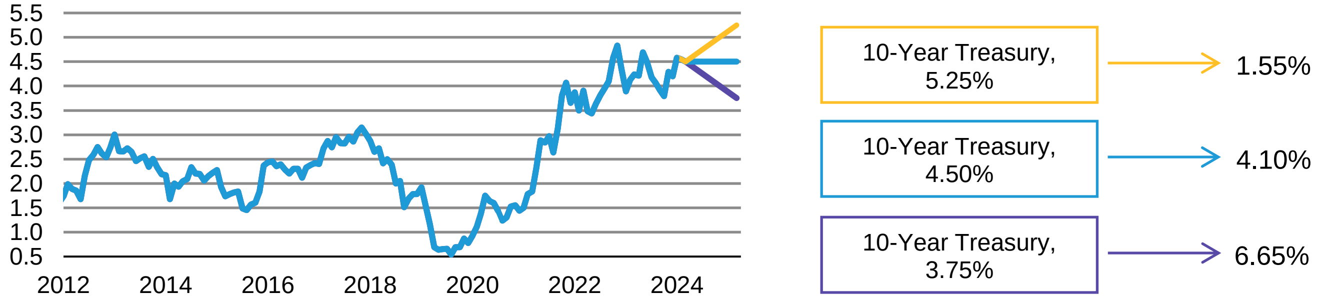


A thoughtful blend of high-grade and credit bonds along with a barbell maturity structure can add as much as 100 bps in yield to a portfolio.

Muni credit blend is a blend of Bloomberg muni indices: 55% high-grade, 30% A/BBB and 15% high-yield.
As of February 7, 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 February 7, 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