AllianceBernstein

Weekly Market Commentary

The Week in Muniland

February 18, 2025

Spin Cycle

Key Takeaways

1. **It was a volatile week in the municipal market. The market initially sold off following CPI, but did find some stability in the subsequent days.**

2. **Inflation ran hotter than expected in January.**

3. **The municipal yield curve has continued to steepen this year.**

Last week was a rollercoaster ride. Wednesday's stronger-than-expected CPI print initially drove yields higher, but the fixed-income markets snapped back on Thursday and recouped some of those losses. For the week, two-, 10- and 30-year AAA municipal yields rose 8, 11, and 8 basis points (bps), respectively. The Bloomberg Municipal Bond Index (Index) returned –0.22% last week and has returned 0.71% this year.

- **Why it matters:** Despite the recovery toward the end of the week, the municipal market did modestly underperform US Treasuries (USTs) on a relative basis, with after-tax spreads widening 7-10bps across the curve. As a result, municipal valuations have become more attractive (*Display 3*), with short- and intermediate-maturity after-tax spreads now close to fair value—and longer maturities continuing to look quite attractive on a relative value basis. Some of last week's underperformance can be attributed to slightly softer demand. Inflows to the market last week totaled $238 million, which, while still positive, is a decelerated pace compared to previous weeks. Year to date, demand has been quite strong, with investors adding nearly $6.5 billion, according to Lipper. Next week's calendar is looking extremely light, with just $5.7 billion expected to price.

Inflation ran hotter than expected in January, with core CPI up 0.4% month over month and 3.3% year over year.

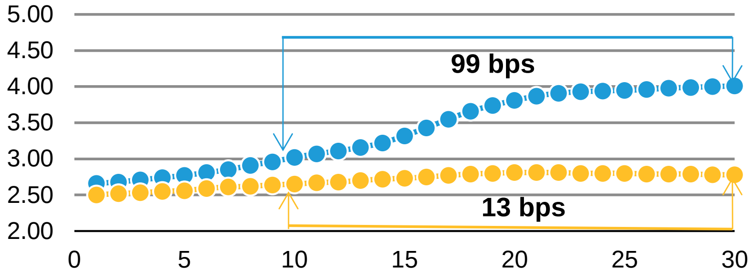
- **Why it matters:** As we have discussed in prior months, downward progress toward the Fed's inflation target has stalled, and as such, the Fed has paused its easing cycle. This CPI print supports the idea of an extended pause, suggesting no major implications to policy. The Fed was on hold before, and this will only serve to keep it on hold. Not only has disinflationary progress stalled over the past few months, the three-, six-, and 12-month run rates are all now either flat or rising. With several Fed speakers recently indicating that the Federal Open Market Committee will need to see renewed momentum (toward target) in order to resume rate cuts, it's clear that the Fed will be on hold for several months. That said, we do believe that some of the rise in inflation this month stems from residual seasonality and beginning-of-year price changes. In each of the past two years, the highest inflation prints have come in Q1, catching the market off guard, and then the inflationary pressures have ebbed over the rest of the year. Overall, we still believe that disinflation will resume in the coming months, and that should allow the Fed to resume cutting rates as the year progresses. To be sure, though, it will require a few months of slower inflation before the Fed begins to cut again.

The municipal yield curve's steepening trend has carried over from 2024 into 2025.

- **Why it matters:** The year 2024 saw a massive steepening of the yield curve, and investors who implemented a barbell maturity structure were certainly rewarded. So while the muni yield curve has continued to gain more curvature this year, the opposite has happened in the UST curve, which has flattened. For example, the 2s30s UST curve has flattened this year by 10 bps, whereas the 2s30s AAA muni curve has steepened by 25 bps. In addition, longer-maturity municipals look more attractive on a relative value basis compared to short maturities. The combination of a steep curve and attractive valuations creates an attractive opportunity for investors in longer-maturity bonds, which can be paired with shorter-duration maturities to maintain a balanced overall portfolio duration profile.

Displays of the Week: February 18, 2025

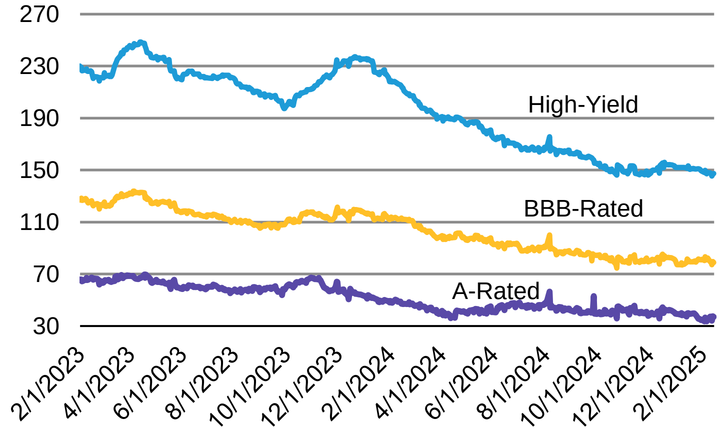
Display 1: Municipal Yield Curve vs. US Treasury Curve After Tax* (Percent)



*Tax rate used: 40.8%
As of February 14, 2025. Source: Municipal Market Data and AB

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.

Display 2: Municipal Credit Spreads (Basis Points)



As of February 14, 2025
Source: Bloomberg and AB

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

Display 3: Municipal and Treasury After-Tax Spreads (Basis Points)

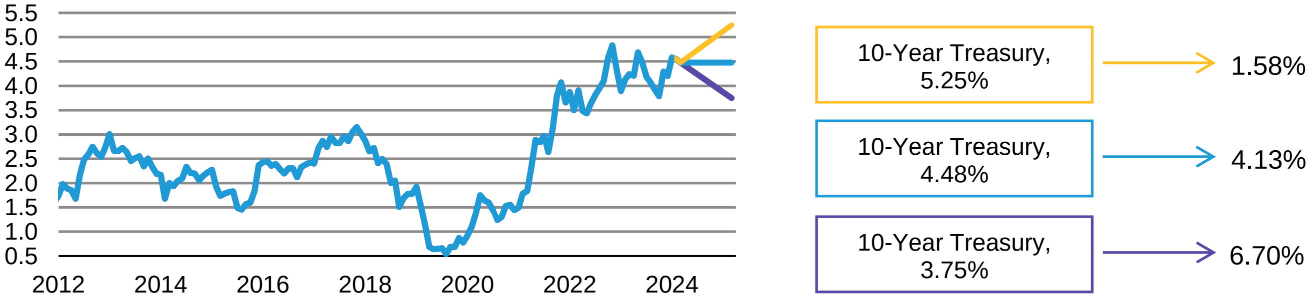
	Feb 14, 2025	Feb. 7, 2025	Five-Year Average
Two-Year	16	6	16
Five-Year	20	11	22
10-Year	38	27	43
15-Year	58	50	67
20-Year	99	91	75
30-Year	122	115	95

As of February 14, 2025. Source: Bloomberg and AB

Municipal valuations now look more attractive, particularly on the long end of the curve.

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 14, 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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