ALLIANCEBERNSTEIN®

Weekly Market Commentary

The Week in Muniland

February 24, 2025

Head on a Swivel

Key Takeaways

1. **It was a boring week in muniland, but the muni market was still positive.**
2. **Keep your head on a swivel and stay active as the market remains uncertain.**
3. **There are different ways investors can capitalize on current opportunities.**
4. **Join us Tuesday, March 4 for our muni webcast; The Active Edge: Tech-Enhanced Muni Bond Portfolios.**

You will rarely hear us say the following: the muni market was a bit boring last week. There was no meaningful economic data to digest and yields were slightly lower. For the week, two-, 10- and 30-year AAA municipal yields fell 4, 6, and 4 basis points (bps), respectively. The Bloomberg Municipal Bond Index (Index) returned 0.17% last week and has returned 0.89% this year.

- **Why it matters:** Munis have been slow and steady (steady may be a stretch) for the first couple of months of the year. The Index returned 0.51% in January and 0.38% in February. The supply and demand backdrop has been favorable, with $7 billion of inflows into mutual funds and exchange-traded funds—an indication of strong muni demand. Nearly 60% of demand has gone into longer-duration strategies, while 40% has gone into higher-yielding strategies. This shows that investors are seemingly willing to take on a bit more risk. This week's new issue calendar is relatively average for this time of year, with $8.3 billion of tax-exempt bonds expected to come to market. With March 1 coupon payments around the corner, next week's calendar should be well-digested.

We often get asked, what keeps you up at night? I can't say we're losing sleep, but we can certainly say our heads are on a swivel.

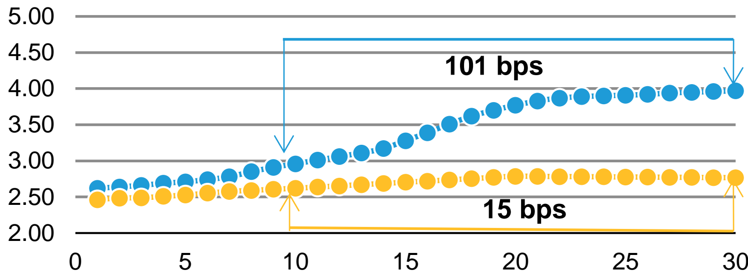
- **Why it matters:** There will always be uncertainty in any market, but there is clearly more uncertainty today than normal. Whether it be Fed policy, inflation, yield volatility, yield-curve shifts, President Trump's proposed federal expense cuts, risks to municipal bond tax exemption, a slowing economy, or general supply and demand, there's a lot of factors to consider when managing a bond portfolio. With all of these variables, why would any investor take a passive, buy-and-hold approach? 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 rolling 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. 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.

Given all of the uncertainty and volatility, how should investors position their portfolio in today's market?

- **Why it matters:** First, investors should take advantage of the steep municipal yield curve (*Display 1*). The muni curve is steep both relative to history, and to the after-tax US Treasury curve. Just like the inverted muni curve did not last, this steepness will not last forever. We recommend investors still employ a barbell maturity structure, which takes advantage of the cheap long end, coupled with shorter maturity bonds. Second, selectively own bonds rated A, BBB and noninvestment-grade (*Display 2*). Strong fundamentals, coupled with strong demand for these bonds creates an opportunity to enhance both yield and return (*Display 3*). Third, modestly add duration in an environment where we expect yields to fall over the next 12–18 months. Finally, when able, add tax-efficient inflation protection to protect against increasing inflation expectations. Not all of these positions may work to your advantage at the same time, but as we mention above, being active in your positioning will generally pay off compared to a static portfolio.

Displays of the Week: February 24, 2025

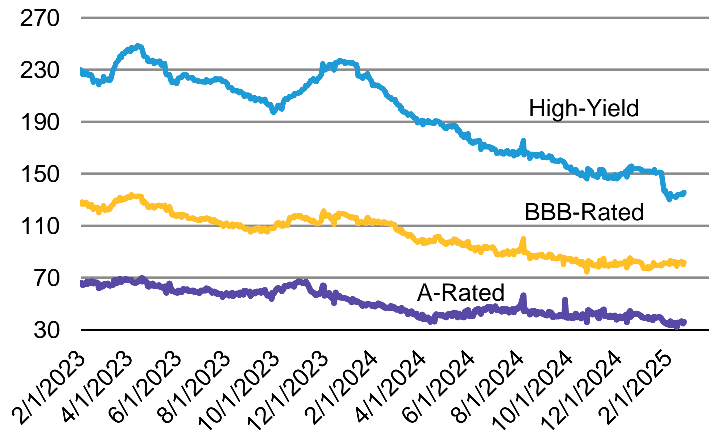
Display 1: Municipal Yield Curve vs. US Treasury Curve After Tax* (Percent)



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 21, 2025. Source: Municipal Market Data and AB

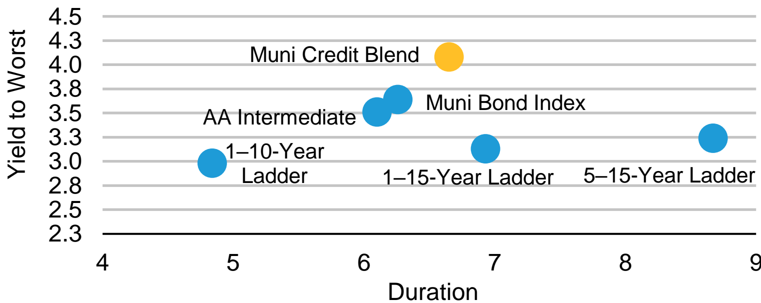
Display 2: Municipal Credit Spreads (Basis Points)



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

As of February 21, 2025
Source: Bloomberg and AB

Display 3: Portfolio Construction for Today (Percent)

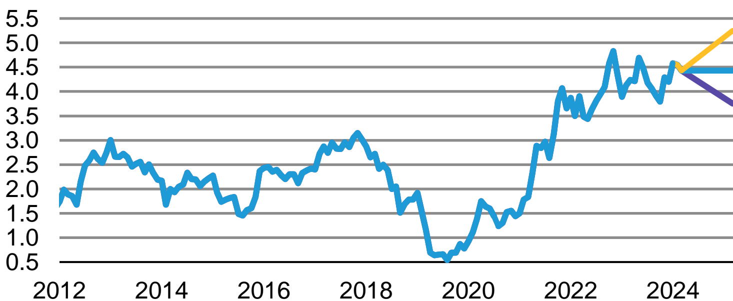


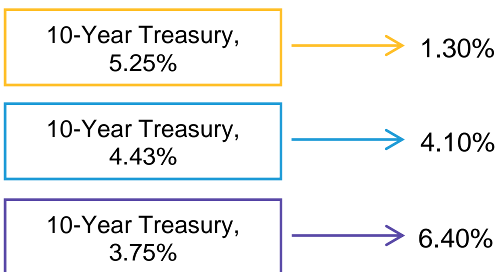
A thoughtful blend of high-grade and credit bonds along with a barbell maturity structure can add nearly 100 bps in yield to a portfolio.

Muni credit blend is a blend of Bloomberg muni indices: 60% high-grade, 30% A/BBB and 10% high-yield.
As of February 21, 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 21, 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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