ALLIANCEBERNSTEIN®

Weekly Market Commentary

The Week in Muniland

March 17, 2025

Staying Calm Is a Superpower

Key Takeaways

1. **Municipal bonds are cheap relative to taxable bonds, creating an opportunity for crossover buyers.**
2. **Investors should take advantage of the steep municipal yield curve.**
3. **February inflation came in lower than anticipated.**

Let's call last week what it was: a punch in the gut. The muni market significantly underperformed the US Treasury (UST) market as new issue supply overwhelmed. For the week, two-, 10- and 30-year AAA municipal yields rose 6, 16 and 16 basis points (bps), respectively, while UST yields were basic ally flat. The Bloomberg Municipal Bond Index (Index) returned –0.89% last week and has now returned only 0.07% year to date.

- **Why it matters:** The underperformance of munis has resulted in munis becoming cheap relative to USTs (*Display 3*). This cheapness is most evident in the long end of the yield curve—most notably, the 20s30s part of the curve. Typically, when the muni market becomes cheap, crossover buyers step in to buy cheap muni bonds. Crossover buyers are taxable bond buyers who purchase muni bonds when they become cheap relative to taxable bonds. If enough crossover buying occurs, that demand can provide a floor to bond prices. We're not saying we've reached a floor, but crossover activity is increasing.

The muni yield continues to steepen, providing potential outsize opportunities for investors.

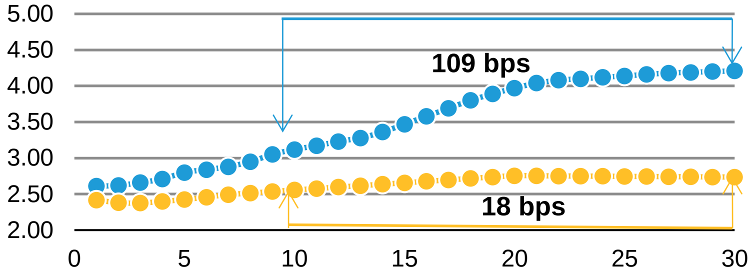
- **Why it matters:** The muni curve has continued to gain even more curvature this year, with the 2s30s and 10s30s curves widening 48 and 26 bps, respectively. The muni curve is nearly six times as steep as the UST curve, after tax (*Display 1*). We highlight the 10s30s slope in Display 1, but the most attractive part of the curve is actually the 10s20s range. At 85 bps steep, the 10s20s part of the curve offers an attractive opportunity to profit from roll-down math. In essence, roll-down math is profiting through the passage of time due to a steep yield curve. It's basically a freebie. In today's market, roll is worth nearly 100 bps of return in the 17-year part of the curve. Continued support from strong investor demand should provide an additional tailwind to longer-dated bonds. Year to date, demand for the long end of the curve has been strong, with 58% of mutual fund and exchange-traded fund flows going into long-dated strategies. However, during this past week, long-dated strategies realized $373 million of outflows. That's not surprising given the market's recent performance, but now is not necessarily the time to flee the market. With a steep muni curve, attractive roll opportunities and the likelihood of the economy slowing and yields falling, investors should be looking to run into, not away from, long bonds. Staying calm when the market is turbulent is an investor's superpower.

February's CPI came in softer than anticipated; the expectation that inflation will slowly grind lower continues.

- **Why it matters:** As we have noted previously, we expect inflation to moderate over time, though that path is never linear. Tariffs can impact inflation, but we wouldn't expect the Fed to react to a one-time change in price. The more likely risk is a slowing economy. If the economy begins to slow and inflation remains somewhat anchored, the Fed will likely need to cut rates, causing yields to fall. The market is pricing in three Fed rate cuts this year, with the first cut expected at the June 18 Federal Open Market Committee meeting. If the Fed does cut rates, bonds—especially longer-maturity bonds—will rally and the muni curve will likely flatten over time.

Displays of the Week: March 17, 2025

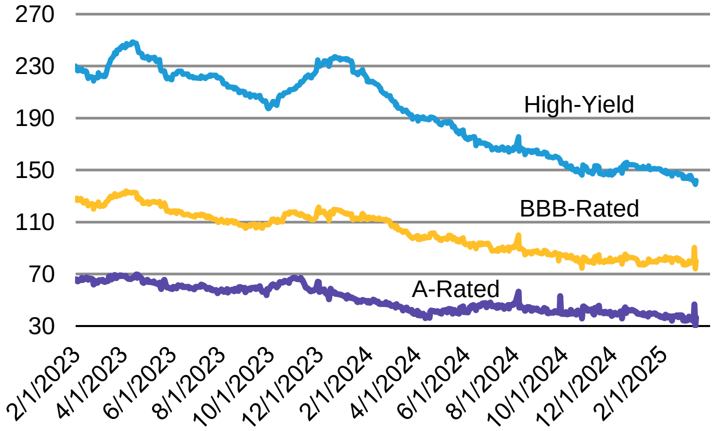
Display 1: Municipal Yield Curve vs. US Treasury Curve After Tax* (Percent)



Tax rate used: 40.8%
As of March 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 March 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/Treasury After-Tax Spreads (Basis Points)

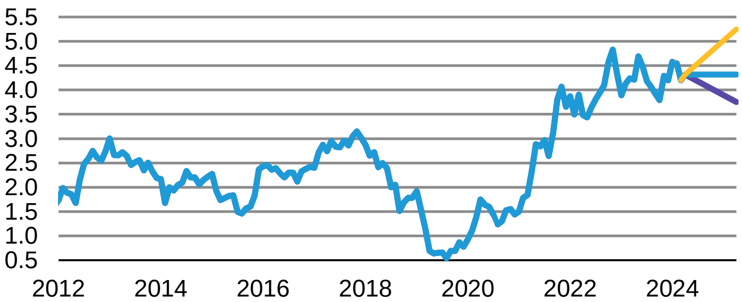
	Mar 14, 2025	Feb 28, 2025	Five-Year Average
Two-Year	23	18	16
Five-Year	37	25	22
10-Year	57	38	43
15-Year	80	61	67
20-Year	120	102	75
30-Year	147	128	95

As of March 14, 2025.Source: Municipal Market Data, Bloomberg and AB

Municipal bonds have underperformed US Treasuries during March and are now relatively cheap.

Display 4: Expected 12-Month Municipal Returns Scenario Analysis

10-year US Treasury Yield (Percent)



10-Year Treasury, 5.25% → 1.00%

10-Year Treasury, 4.32% → 4.30%

10-Year Treasury, 3.75% → 6.30%

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 March 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