July 25, 2024

Investment Insights

Thoughts From The Municipal Bond Desk

Mark Paris
Chief Investment Officer,
Invesco Municipal Bond team

Tim Spitz
Head of Municipal Business
Strategy & Development

Overview

- Given that inflation eased in June, some investors are expecting the Fed to start cutting interest rates in mid September.
- Historically, municipal ratios trend down during Fed easing cycles, suggesting tax-exempt municipals could perform well once rate cuts begin.
- Investors may benefit from monthly dividend income, as yields are likely to stay elevated for some time.
- Some smaller, private higher educational institutions are under financial pressure as expenses continue to increase and enrollments are projected to decrease.

Tim: Inflation eased in June, suggesting the Federal Reserve (Fed) might cut interest rates in September. If so, what do you think the impact will be on the municipal market?

Mark: The Fed was widely expected to wait until November, given the discouraging data we saw in May. Inflation cooled in June, which led to some market participants to forecast a September rate cut, followed by a series of quarterly rate cuts.[1] Once the Fed starts easing, I anticipate seeing positive returns in the municipal market. During past rate cutting cycles, municipal ratios have trended down, making municipal valuations richer than those of comparable duration US Treasury securities.[2] Should this occur again, tax-exempt municipals are likely to benefit, in my view. At the same time, I anticipate a rise in demand for shorter maturities, which could push down short-term yields and push up bond prices.

Tim: What about the immediate future?

Mark: I don't expect much changing in the municipal market during the summer months. New issuance should remain robust ahead of the November elections and then decline, with significantly lower volumes into year-end.[3] However, the heavy supply may cause some market volatility in the early part of the fall. As for yields, I think they may stay elevated ahead of the Fed's policy meeting in mid-September, but rate volatility is likely to continue across fixed income sectors, in my view, as market participants parse every economic release and investor sentiment shifts back and forth on the timing and size of Fed rate cuts. On a positive note, as muni investors wait for the Fed to act, they are getting monthly dividend income for their patience.

Tim: Some private colleges and universities are facing substantial headwinds, which has raised concern about the outlook for the higher education sector. What are your thoughts?

Mark: The cost of higher education is growing — for both students and colleges. Undergraduate students who live on campus at private four-year colleges paid, on average, $57,000 in tuition during the 2022-2023 school year.[4] While private colleges have continued to raise tuition, the increase in revenue has not been sufficient to offset higher expenses. In the 2023 fiscal year, private colleges saw margins decline to their lowest levels in more than 10 years.[5] The credit outlook for smaller, private colleges seems likely to continue to deteriorate. After the Great Recession in the mid-2000s, the US birth rate dropped, shrinking the number of future high school graduates, and the less-than-ideal revamp of the Free Application for Federal Student Aid will likely dampen enrollment this fall.[5] According to Fitch Ratings, the smaller, tuition dependent colleges are likely to be hurt the most by the changing demographics.[5] Our 23-person credit team is monitoring this sector closely and we continue to rely on our extensive bottom-up research capabilities to find pockets of opportunity.

Munis by the numbers

A quick look at some commonly used municipal market datapoints.

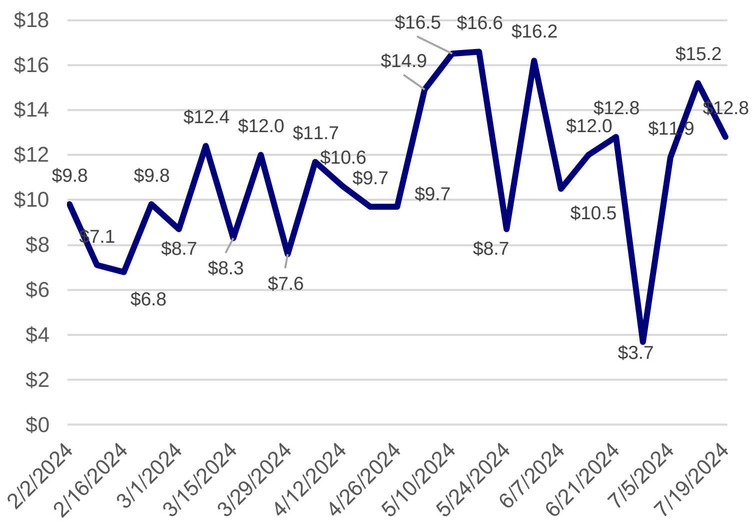
Fund Flows - Weekly and Monthly Reporters ($millions)

Week ended July 17, 2024

	Combined	Open End Mutual Funds	ETFs
All term muni funds	13,299	9,607	3,693
Investment Grade	5,047	1,346	3,701
High Yield	8,252	8,261	(8)
Long Term (10yr +)	15,914	13,184	2,730
Intermediate (5-10yr)	1,888	704	1,183
Short / Intermediate (3-5yr)	(2,060)	(1,549)	(512)
Short (1-3yr)	(2,442)	(2,733)	291
National funds	12,789	9,614	3,176
New York	168	66	102
California	1,337	923	414

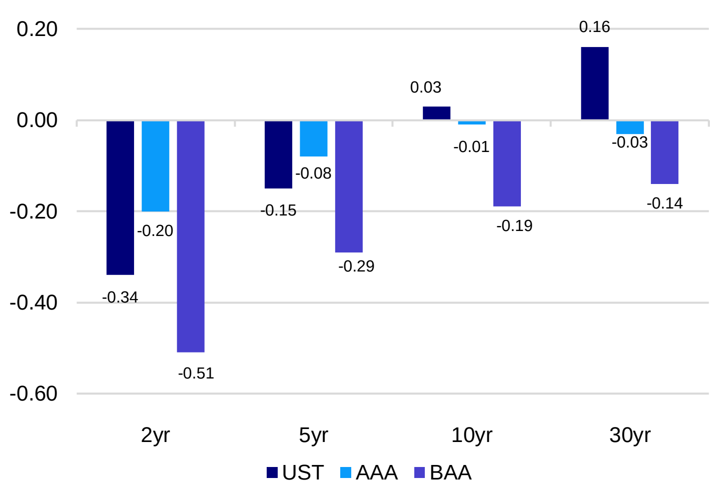
Source: Year to date LSEG Lipper Global Fund Flows, J.P. Morgan. Data refreshed on July 17, 2024. Note: Figures shown on this table are combination of weekly and monthly reporters.

30-day Visible Supply ($billions)



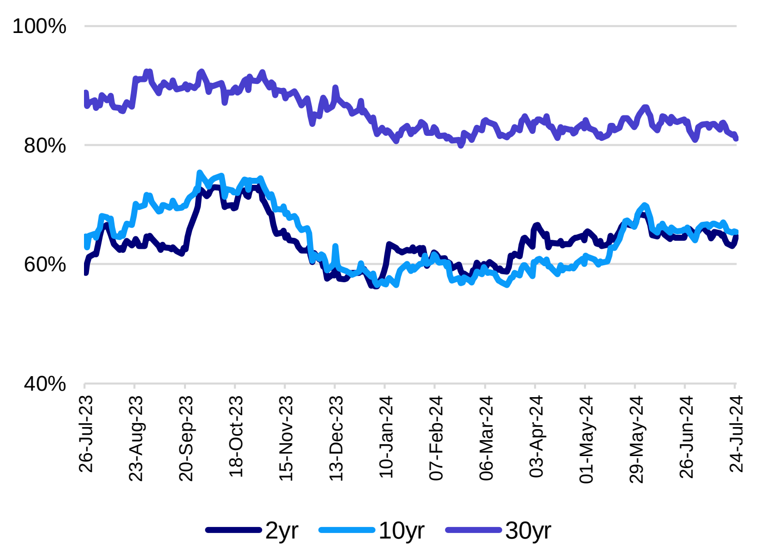
Source: Bloomberg. Bond Buyer Weekly 30-Day Visible Supply - Total dollar volume of bonds to be offered over the next thirty days. It does not include 'Sealed Bids Invited' or 'Proposed Bond Issues'. Only includes Municipal Bonds. From February 2, 2024 – July 19, 2024.

1-Month Yield Change 6/24/24 – 7/24/24 (% Change)



Source: Refinitiv MMD Curve, US Department of Treasury, from June 24, 2024 – July 24, 2024. UST = United States Treasury. A credit rating is an assessment provided by a nationally recognized statistical rating organization (NRSRO) of the creditworthiness of an issuer with respect to debt obligations, including specific securities, money market instruments or other debts. Ratings are measured on a scale that generally ranges from AAA (highest) to D (lowest); ratings are subject to change without notice. NR indicates the debtor was not rated and should not be interpreted as indicating low quality. For more information on rating methodologies, please visit the following NRSRO websites: www.standardandpoors.com and select 'Understanding Credit Ratings' under Rating Resources 'About Ratings' on the homepage.; www.ratings.moodys.com and select 'Rating Methodologies' under Research and Ratings on the homepage.; www.fitchratings.com and select 'Ratings Definitions Criteria' under 'Resources' on the homepage. Then select 'Rating Definitions' under 'Resources' on the 'Contents' menu.

Municipal/Treasury Ratio



Source: Thomson Reuters TM3, as of July 24, 2024. Treasuries are backed by the full faith and credit of the US government as to the timely payment of principal and interest, while legislative or economic conditions could affect a municipal securities issuer's ability to make payments of principal or interest.

Sources:

1. JP Morgan, as of July 12, 2024.
2. Bloomberg, June 30, 2024. Municipal/Treasury ratios in previous rate-cutting cycles: November 25, 2008 – March 31, 2010, ratio change122.71% to 83.44%; November 3, 2010 – June 30, 2011, ratio change 101.87% – 89.37%; September 13, 2012 – December 29, 2014, ratio change 107.95% – 97.78%; March 9, 2020 – March 9, 2022, ratio change 149.72% – 90.38%. Treasuries are backed by the full faith and credit of the US government as to the timely payment of principal and interest, while legislative or economic conditions could affect a municipal securities issuer's ability to make payments of principal or interest.
3. Barclays, as of July 10, 2024.
4. National Center for Education Statistics, as of July 3, 2024.
5. Fitch Ratings, as of July 3, 2024.

About risk

Municipal securities are subject to the risk that legislative or economic conditions could affect an issuer's ability to make payments of principal and/or interest.

Junk bonds involve greater risk of default or price changes due to changes in the issuer's credit quality.

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested. The values of junk bonds fluctuate more than those of high-quality bonds and can decline significantly over short time periods.

All fixed income securities are subject to two types of risk: credit risk and interest rate risk. Credit risk refers to the possibility that the issuer of a security will be unable to make interest payments and/ or repay the principal on its debt. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa.

Municipal bonds are issued by state and local government agencies to finance public projects and services. They typically pay interest that is tax-free in their state of issuance. Because of their tax benefits, municipal bonds usually offer lower pre-tax yields than similar taxable bonds.

All data as of July 24, 2024, unless otherwise stated.

All data provided by Invesco unless otherwise noted.

The opinions expressed are those of the author, are based on current market conditions and are subject to change without notice. These opinions may differ from those of other Invesco investment professionals.

Invesco does not provide tax advice. The tax information contained herein is general and is not exhaustive by nature. It is not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding tax penalties that may be imposed on the taxpayer under US federal tax laws. Federal and state tax laws are complex and constantly changing. Investors should always consult their own legal or tax professional for information concerning their individual situation.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

Past performance does not guarantee future results. An investment cannot be made into an index.

Forward-looking statements are not guarantees of future results. They involve risks, uncertainties and assumptions, there can be no assurance that actual results will not differ materially from expectations.

There is no guarantee the outlooks mentioned will come to pass.