Investment Insights

Thoughts From The Municipal Bond Desk

Stephanie: Wow, it’s been exactly one year since we started publishing this piece! Time certainly flies when you’re having fun! Last December we were bracing ourselves for a market that was expected to continue to sell-off for some time or enter a recession. As we begin 2024 what are you and the team getting ready for?

Mark: What a difference a year makes! This year we’re looking forward to a continued rally as we enter 2024, not as quick as we saw last month, more paced, but still upward sloping. We believe that demand will shift back to positive and will likely stay consistently positive for most of the year. Next year we’re expecting a resurgence of the ho-hum normal seasonal pattern that we typically have in the muni market: strength in January and February, slight pull-back in March and April, strength during the late spring and summer months, pull-back in the Fall and ending the year with positive momentum.¹

Stephanie: What about municipal credits, we’ve talked a lot this year about significantly positive upgrade to downgrade ratios, are you expecting that to continue into 2024?

Mark: I think the peak in the municipal credit cycle is now behind us and we’ll start to see credits begin to normalize. I continue to believe that collectively, municipal credit is the strongest it’s ever been, which doesn’t leave much room for upward improvement. I think what we’ll see in 2024 is stability of credit, fewer upgrades, but likely not an increase in defaults. We believe muni credit will continue to be in good shape overall as funds from federal pandemic aid and strong tax collections continue to strengthen balance sheets while fiscal restraint will help to keep most credits in a resilient position. In 2023 Moody’s Investors Service (Moody’s) and S&P Global Ratings upgraded more than 1,400 ratings and downgraded less than 350 ratings—a combined upgrade/downgrade ratio of 4 to 1.² That’s remarkable and likely not sustainable.

Stephanie: We’ve started to hear some discussion about sunsetting tax provisions from the 2017 Tax Cuts & Jobs Act (TCJA). Most of what I’ve seen won’t expire until December 31, 2025. Do you think it’s too early for taxpayers to start preparing for the changes?

Mark: My motto is it’s never too early to worry about Uncle Sam! Without additional policy change, in just a few years, many Americans might be facing much larger tax liabilities than they’ve become accustomed to in recent years. Some of the most notable changes when the TCJA sunsets will be the top tax bracket going from 37% back to 39.6%, and for those in tax brackets where rates were lowered because of the TCJA, they would see those tax rates increase on average by 4.2%.³ TCJA also nearly doubled the standard deduction, the child tax credit, and the estate tax exemption. All of these would also sunset in 24 months. For those that want to plan ahead, the current muni market environment could present an attractive entry point that could put buyers “ahead of the pack.”

Overview
- As we close out a volatile 2023, the Muni market is anticipating getting back to its normal seasonal pattern in 2024.
- Municipal issuers have taken advantage of federal pandemic aid and healthy tax receipts to help build strong credit foundations.
- While credit has likely peaked, 2024 is expected to be the year of credit stability.
- Provisions from the 2017 Tax Cuts & Jobs Act begin to sunset at the end of 2025 and could mean a much larger tax bill for many Americans. An investment in munis can potentially prove beneficial for those that want to begin preparing for the change.
Munis by the numbers
A quick look at some commonly used municipal market datapoints.

Fund Flows - Weekly and Monthly Reporters ($millions)
2023 Year-to-date

| Source: Year to date LSEG Lipper Global Fund Flows, J.P. Morgan as of December 7, 2023. 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 June 16, 2023 – December 8, 2023.

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Source: Refinitiv MMD Curve, US Department of Treasury, from November 13, 2023 – December 13, 2023. 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 'Ratings Definitions' under 'Resources' on the 'Contents' menu.

1-Month Yield Change 11/13/23 – 12/13/23 (% Change)

Source: Thomson Reuters TM3, as of December 13, 2023. 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.

Municipal/Treasury Ratio

Source: Year to date LSEG Lipper Global Fund Flows, J.P. Morgan as of December 7, 2023. Note: Figures shown on this table are combination of weekly and monthly reporters.

Investment Insights | Invesco Fixed Income 2

2023 Year-to-date

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<thead>
<tr>
<th>Combined</th>
<th>Open End Mutual Funds</th>
<th>ETFs</th>
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<tbody>
<tr>
<td>All term muni funds</td>
<td>(14,578)</td>
<td>(25,503)</td>
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<tr>
<td>Investment Grade</td>
<td>(15,691)</td>
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<td>High Yield</td>
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<td>Long Term (10yr +)</td>
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<td>Intermediate (5-10yr)</td>
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<td>Short / Intermediate (3-5yr)</td>
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<td>Short (1-3yr)</td>
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<td>National funds</td>
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<td>California</td>
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<tr>
<td>New York</td>
<td>(1,376)</td>
<td>(2,366)</td>
</tr>
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Source: Year to date LSEG Lipper Global Fund Flows, J.P. Morgan as of December 7, 2023. Note: Figures shown on this table are combination of weekly and monthly reporters.
Sources:

1. JPM, as of December 31, 2022, based on a 5-year average of net supply from 2017-2022: January: -$9bn; February: -$10bn; March: $0; April: $1bn; May: -$2bn; June: -$5bn; July: -$17bn; August: -$14bn; September: $4bn; October: $5bn; November-$5bn; December: -$10bn. Market technicals include supply and demand for a security and how it can affect changes in price, volume, and volatility. Net negative supply allows for favorable technicals in the municipal market.
2. BofA Global Research, as of December 1, 2023.

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 pay interest that is typically 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 December 13, 2023, unless otherwise stated.

All data provided by Invesco unless otherwise noted.

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