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Investment Insights

Anatomy of a Municipal Comeback

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Key Takeaways

- Investor behavior can have a big impact on investment results over time.
- Sitting in cash is costly. Municipal bonds nearly always outperform T-bills.
- Recoveries happen quickly. Missing the first few months of a recovery can eliminate much of the returns.

In the following pages we explore some risks of investor behavior that may have a long-term impact on results. We have broken the story down to highlight 3 investor behaviors that can be detrimental to investment results.

Risks:
1. Market Timing: The high cost of market timing in fixed income
2. Sitting in cash: Scared money rarely wins
3. Waiting for the bottom: It may be better to be early than late

Risk #1: Market Timing

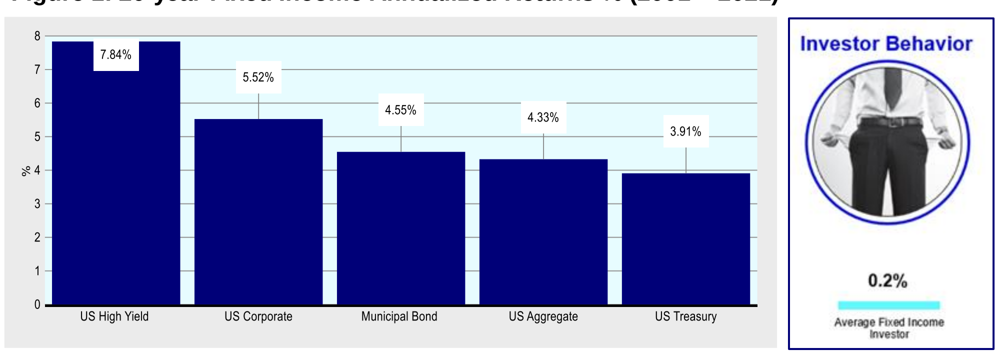
1. The average investor has earned 0.2% annualized over 20 years versus 4.55% for municipal bonds in that same time period.
2. This demonstrates the high cost of attempting to time the markets.

Risk #1: Market Timing

What has the greatest impact on investment results?

According to a recent DALBAR study, the average fixed income investor has earned 0.2% annualized over the past 20 years as seen in Figure 1. This disparity of returns is most likely due to investors moving money between asset classes at times that is not beneficial to overall results. This highlights the high cost of market timing

Figure 1: 20-year Fixed Income Annualized Returns % (2001 – 2021)



Source: Macrobond. Indices shown are the Bloomberg Municipal Bond Index, the Bloomberg US High Yield Index, the Bloomberg US Treasury Index, the Bloomberg US Aggregate Bond Index, and the Bloomberg US Corporate Index. Investor Behavior callout is showing the Average Fixed Income Investor's return is based on an analysis by DALBAR, Inc. which utilizes the net of aggregate mutual fund sales, redemptions, and exchanges each month as a measure of investor behavior from 2001-2021. Past performance is not a guarantee of future results. An investment cannot be made in an index.

Risk #2: Sitting in Cash

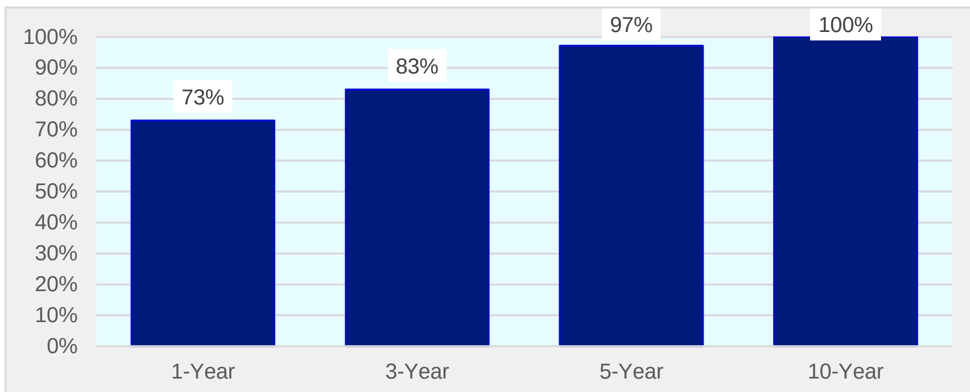
1. Over rolling ten-year periods, municipal bonds have outperformed T-bills 100% of the time
2. Calendar year performance for municipal bonds is positive nearly 90% of the time with an average return of 7.41%.

Risk #2 – Sitting in cash

How often do bonds outperform cash equivalents?

Figure 2 compares the annualized returns of the Bloomberg Municipal Bond Index versus T-bills. Municipals have outperformed T-bills 97% of the time in a rolling 5-year period, and 100% of the time in a rolling 10-year period.

Figure 2: % of time Municipal Bonds have outperformed T-Bills (2012-2022)

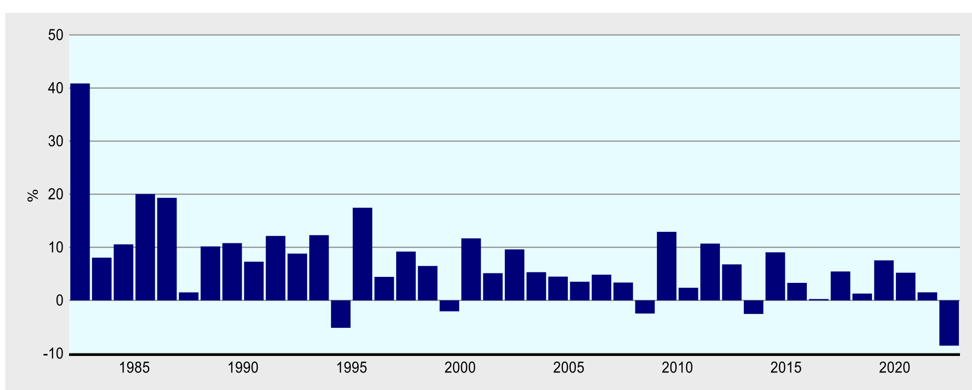


Source: Macrobond. Historical analysis reviews Bloomberg Municipal Bond Index and Bloomberg US Treasury Bills annualized rolling return data dating back to 2012. The calculation measures how often Corporate Bonds on a rolling 12-month basis have provided a higher return than T-bills measured in that same rolling 12-month period. T-bills, unlike muni bonds, are backed by the full faith and credit of the US government and as a result exhibit less risk/volatility. An investment cannot be made in an index. Past performance is not a guarantee of future results.

How often are municipal bond returns negative?

There have only been 4 calendar years with negative returns in the Bloomberg Municipal Bond Index since inception in 1980 (Figure 3). Nearly 90% of the time, index returns have been positive with an annualized average return of 7.14%.

Figure 3: There have only been nine calendar years since 1974 with negative returns



Source: Macrobond. Bloomberg Municipal Bond Index calendar return data dating back to index inception. An investment cannot be made in an index. Past performance is not a guarantee of future results.

Risk #3: Waiting for the bottom to get back in

1. Market timing is nearly impossible as the rebound can happen very quickly.
2. The average number of months to recovery for a drawdown is eight months.
3. The 12-month period after a cycle low has historically provided strong returns.

Risk #3: Waiting for the bottom to get back in

How quickly does a recovery happen after a drawdown of more than 5%?

Since inception of the index in 1980, there have been nine periods with a drawdown of greater than 5%. Figure 4 shows that the average number of months to a recovery after a drawdown is six months.

Figure 4: Drawdown of greater than -5% since index inception

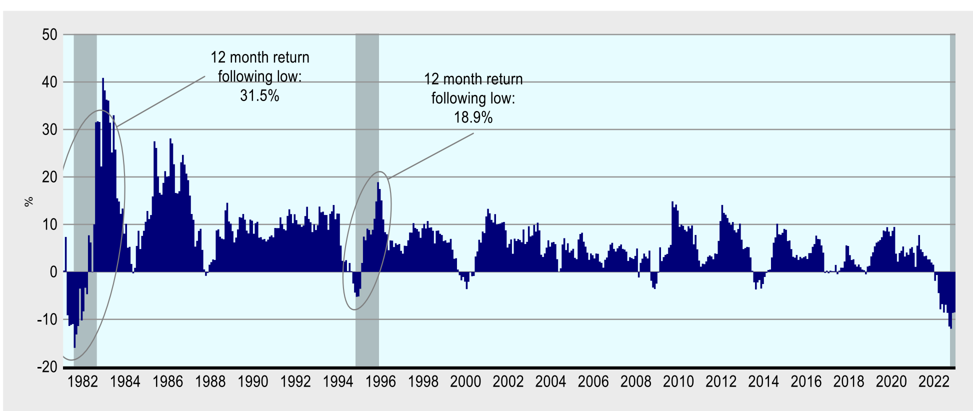
Drawdown greater than -5%	Peak to trough %	Months of drawdown	Months to Recovery
Low: Mar 1980	-5.2%	1	1
Low: Aug 1981	-22.4%	14	12
Low: May 1984	-6.6%	4	2
Low: May 1987	-6.5%	3	8
Low: Nov 1994	-8.3%	10	4
Low: Oct 2008	-5.7%	2	4
Low: Jan 2011	-5.0%	5	6
Low: Aug 2013	-6.2%	4	8
Low: Nov 2016	-5.2%	3	8
Average		**5**	**6**

Source: Macrobond. Bloomberg Municipal Bond Index drawdown data dating back to index inception. An investment cannot be made in an index. Past performance is not a guarantee of future results.

What does it cost if you are late?

Figure 5 shows that returns are strong in the 12 months following a 12-month rolling return of -5% or greater. This underscores the idea that timing the bottom is very difficult and recoveries happen quickly. Being late by even a few months can be costly.

Figure 5: Municipal bond returns have been strong 12 months after the cycle low



Source: Macrobond. Historical analysis reviews Bloomberg Municipal Bond Index annualized rolling 12-month total return data dating back to index inception (1/31/1980). Grey highlights signify the 12 months following the 12-month annualized low greater than -5%. An investment cannot be made in an index. Past performance is not a guarantee of future results.

Figure 6: Returns have been strong at the end of fed hiking cycles

End of Fed Hiking Cycle	Fed Rate	1 year after	2 years after (annualized)	3 years after (annualized)
Aug 1984	11.75	16.63	19.87	14.52
Feb 1989	9.75	10.26	9.74	9.82
Feb 1995	6.00	11.05	8.24	8.54
May 2000	6.50	12.14	9.29	9.64
July 2006	5.25	4.27	3.54	4.06
Dec 2018	2.50	7.54	6.37	4.73

Source: Macrobond. Bloomberg Muni Bond Index annualized total return data. An investment cannot be made in an index. Past performance is not a guarantee of future results.

Where do we go from here?

Whether we measure returns from the low in a cycle (Figure 5), or the end of a Fed hiking cycle (Figure 6), returns over the next 12 months and beyond should be compelling.

Understanding the high cost of fixed income market timing, and the cost of sitting in cash can help investors make better decisions.

Being a little early has historically been better than being late when the cycle turns. We believe the time is right for investing in Municipal Bond Funds.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

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All data provided is in USD.

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