

## Thoughts From The Municipal Bond Desk



**Mark Paris**

Chief Investment Officer,  
Invesco Municipal Bond team



**Tim Spitz**

Head of Municipal Business  
Strategy & Development

### Overview

- Fixed income performance was disappointing in April, but municipal bonds have historically generated gains in May.
- May, which has historically been a strong month for municipal bonds, got off to a strong start as municipal yields fell along the curve.
- States have started reporting their personal tax receipts for the all-important revenue month of April.
- The expected sunset of the TCJA in 2025 could drive increased demand as individual income tax rates would increase.

**Tim: May has ushered in strong municipal returns after a dismal April. Do you think this bodes well for the summer?**

**Mark:** April was a tough month for fixed income in general, after some discouraging inflation metrics came out; however, we've seen municipal bonds rebound and municipal yields fall along the curve, month-to-date.<sup>1</sup> If history is any guide, May could possibly finish up on a positive note. Since 2004, the municipal bond market has mostly generated gains for May --15 times out of the last 20 years, to be precise.<sup>2</sup> I'm optimistic the next few months, as well, since the summer historically sees lighter supply and greater demand from muni bondholders looking to reinvest their coupon payments.

**Tim: You mentioned sticky inflation numbers. How much do you think the Federal Reserve (Fed) factors into municipal returns this summer?**

**Mark:** The Fed is never too far from our minds. We did see inflation metrics that ticked up slightly in March and April, which disappointed investors who had hoped for a rate cut this summer. As a result, we saw a selloff in fixed income across the board; however, the April jobs report, released on May 3, appears to be showing a slowdown in growth<sup>3</sup>, which buoyed hopes that a rate cut could still happen this year. Thankfully, the fundamentals in the municipal market continue to be strong.

**Tim: Yes, I have noticed that many states are reporting better-than-expected tax receipts. That's got to be reassuring news for municipal bondholders.**

**Mark:** Yes, April is a critical revenue month for states, and in the states that have reported so far, most reflect personal tax receipts above their five-year average.<sup>4</sup> Municipal credits continue to benefit from federal pandemic aid and strong tax collections, which has helped maintain healthy reserves. Although a number of factors suggested the peak of the credit cycle may have passed, I believe rainy day fund levels and fiscal responsibility have the potential to continue to buoy municipalities for some time.

**Tim: So, credit remains strong in the municipal market and we could see an increase in demand if the 2017 Tax Cuts and Jobs Act (TCJA) sunsets in 2025 as expected?**

**Mark:** Yes, we could see additional demand if retail investors see their Federal individual income tax rates increase in 2026. If the TCJA sunsets, the current top tax rate of 40.8% (37% + 3.8% tax on interest income) will increase to 43.4% (39.6% + 3.8%). When income tax rates increase, that makes the value of the tax exemption municipal bonds provide that much more attractive. Put it this way, currently the tax equivalent yield in the highest tax bracket for a municipal bond yielding 5% is 8.45%. If the TCJA sunsets, that same 5% muni yield now has a tax equivalent yield of 8.83%, which is a fairly significant increase!

## Munis by the numbers

A quick look at some commonly used municipal market datapoints.

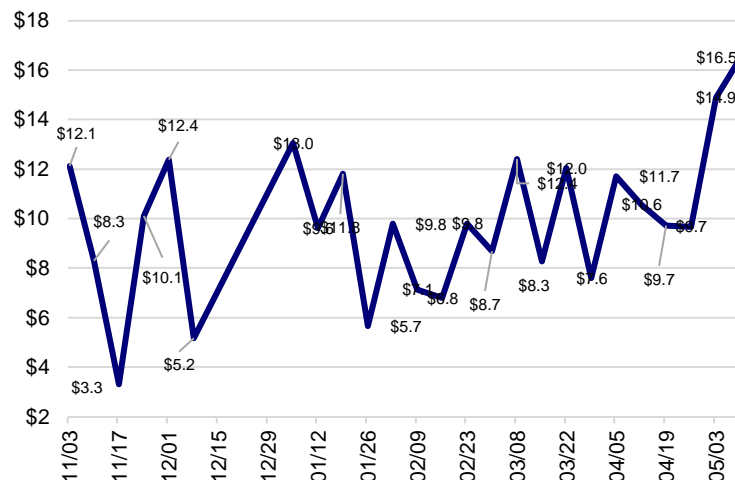
### Fund Flows - Weekly and Monthly Reporters (\$millions)

Week ended May 8, 2024

	Combined	Open End Mutual Funds	ETFs
All term muni funds	10,538	8,813	1,725
Investment Grade	4,861	2,971	1,889
High Yield	5,678	5,842	(164)
Long Term (10yr +)	11,955	10,618	1,337
Intermediate (5-10yr)	1,285	551	734
Short / Intermediate (3-5yr)	(1,082)	(665)	(417)
Short (1-3yr)	(1,620)	(1,691)	71
National funds	9,324	7,952	1,372
New York	270	209	60
California	1,346	1,054	292

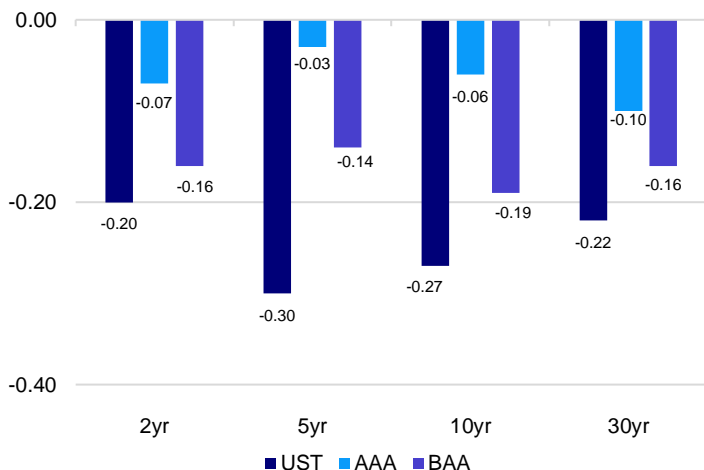
Source: Year to date LSEG Lipper Global Fund Flows, J.P. Morgan. Data refreshed on May 8, 2024. Note: Figures shown on this table are combination of weekly and monthly reporters.

### 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 October 20, 2023 – April 26, 2024.

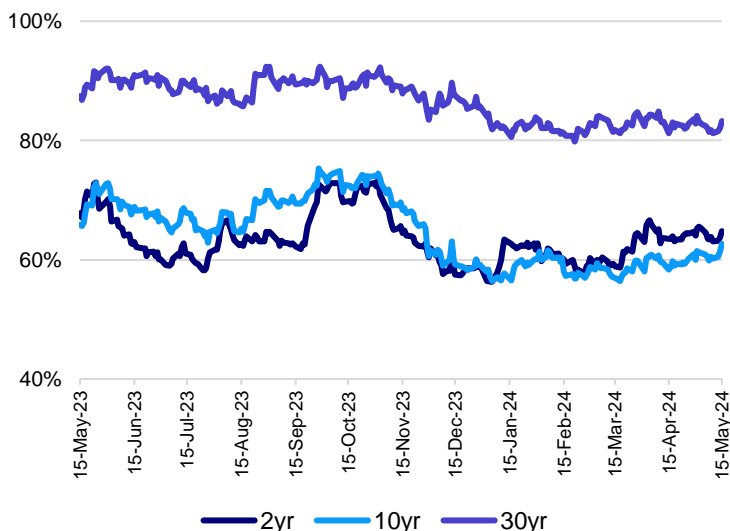
### 1-Month Yield Change 4/15/24 – 5/15/24 (% Change)



Source: Refinitiv MMD Curve, US Department of Treasury, from April 15, 2024 – May 15, 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](http://www.standardandpoors.com) and select 'Understanding Credit Ratings' under Rating Resources 'About Ratings' on the homepage.; [www.ratings.moodys.com](http://www.ratings.moodys.com) and select 'Rating Methodologies' under Research and Ratings on the homepage.; [www.fitchratings.com](http://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 May 15, 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.

Fundamentals refer to the forces of supply and demand in determining price.

#### Sources:

1. The Bond Buyer, as of May 7, 2024. A Yield Curve is a line that plots the interest rates, at a set point in time, of bonds having equal credit quality but differing maturity dates. The Municipal AAA GO bond yield is represented by the Municipal Market Data proprietary yield curve of AAA-rated state general obligation bonds, based on the institutional block size of \$2million-plus market activity in both the primary and secondary bond market. Past performance does not predict future returns. The GO AAA Yield curve decreased 16 basis points (bps) for the 2-year, decreased 13 bps for the 5-year, decreased 15 bps for the 10-year, and decreased 18 bps for the 30-year. A basis point is a unit that is equal to one one-hundredth of a percent.
2. Bloomberg, as of May 1, 2024. The municipal bond market is presented by the Bloomberg Municipal Bond Index. The Bloomberg Municipal Bond Index is an unmanaged index considered representative of the tax-exempt bond market. An investment cannot be made into an index. As of May 31, the Bloomberg Municipal Bond Index has returned the following for each year: 2004, -0.36%; 2005, 0.71%; 2006, 0.45%; 2007, -0.44%; 2008, 0.61%; 2009, 1.09%; 2010, 0.75%; 2011, 1.71%; 2012, 0.83; 2013, -1.22; 2014, 1.29%; 2015, -0.28%; 2016, 0.27%; 2017, 1.59%; 2018, 1.15%; 2019, 1.38%; 2020, 3.18%; 2021, 0.30%; 2022, 1.49%; 2023, -0.87%.
3. Bureau of Labor Statics (BLS), as of May 3, 2024. BLS reported 175,000 jobs were added in April 2024, lower than the average monthly gain of 242,000 over the prior 12 months.
4. J.P. Morgan, as of May 7, 2024. Preliminary data of 9 states reflect California at 16%; Massachusetts at 56%; Illinois at 10%; Pennsylvania at 18%; Alabama at 2%; Kansas at 16%; Arkansas at 15%; West Virginia at -32%; and Montana at 18% for the 5-year for personal income tax receipts.

---

#### 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 May 15, 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.