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

- Relative value continued its return to the muni market, with municipal-to-Treasury ratios at elevated levels in April.
- Credit quality remained stable, with governments likely to reduce spending in response to reduced tax revenues and potentially weaker economic conditions.
- Historically, municipal bonds tend to perform well after periods of stress,[2] so remaining invested may be a prudent decision.
- The tax-exempt income offered by municipal bonds may look even more attractive in the wake of Tax Day.

Tim: The volatility we saw in the municipal market during March has persisted, and then some, into April. What are you thinking in light of the continued turmoil?

Mark: Relative value and active management. With municipal prices down, muni yields are higher. The municipal curve is now steeper than the Treasury curve, which reinforces what I've said previously: relative value has returned to the municipal market. In particular, long-dated munis are the cheapest they've been in some time when you look at their valuations versus Treasurys. On April 22, the municipal-to-Treasury ratio, which compares the yield on an AAA-rated muni bond to a Treasury with the same maturity before adjusting for taxes, was 80% in 5 years, 80% in 10 years, and 94% in 30 years.[1] I think that represents a good relative value for most taxpayers, especially on the longer end of the yield curve.

Tim: So, is that one context in which active management can add value?

Mark: Absolutely. The volatility also offers us the opportunity to book higher yields. The higher dividends compounding should help improve performance in the future, as it has over the long term. But for some investors, staying the course may feel very difficult. There is so much noise out there, so much uncertainty — Federal Reserve monetary policy, fiscal policy, trade policy, tax policy, and geopolitics. It's important to remember that municipal bonds tend to perform well after periods of stress,[2] so I think it makes sense to stay invested.

Tim: Interest rate volatility and worries about US government policy have driven the recent turbulence, right? It's not due to credit fundamentals.

Mark: That's right. Credit quality remains sound, even though economic conditions and tax revenues have weakened. Overall, upgrades continue to outpace downgrades, driven primarily by rating activity in the local government sector.[3] Remember, tax collections, including sales taxes, income taxes, and property taxes, were higher in the past few years than they were before the pandemic, so reserve balances are generally robust and state rainy-day funds are at or near record highs.[4] Furthermore, as many states prepare for their new fiscal year, they are likely to scale back spending, as they have in the face of previous uncertainty and during economic downturns.

Tim: Tax Day came and went last week. I think that whenever people pay their taxes, they may wonder if they can pay less next year.

Mark: Yes, I hear that all the time. Tax-exempt income can be very appealing when you see your tax bill, especially if you are in the higher tax brackets or live in high-tax states. Muni prices may have gone down, but municipal yields are up, so I think it's fair to say that an investor is being "paid" to wait to ride out this volatility. It's also worth noting that munis offer attractive tax-equivalent yields. On April 22, the Bloomberg Municipal Bond Index was yielding 4.26%, or 7.20% on a taxable equivalent basis, while the Bloomberg High Yield Municipal Bond Index was yielding 5.96%, or 10.07% on a taxable-equivalent basis.[5] On the same date, the tax-equivalent yield for an investor in the top tax bracket was near its high of the past 15 years.[6]

Munis by the numbers

A quick look at some commonly used municipal market datapoints.

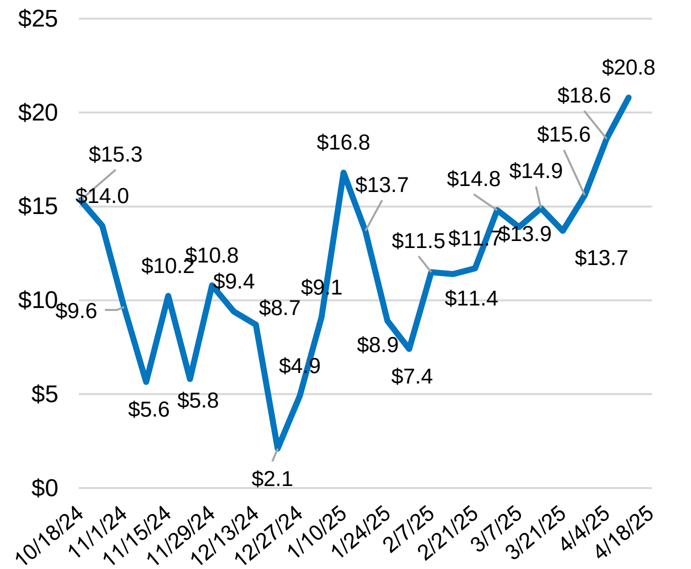
Fund Flows - Weekly and Monthly Reporters ($millions)

Week ended April 16, 2025

	Combined	Open End Mutual Funds	ETFs
All term muni funds	5,271	2,428	2,843
Investment Grade	1,919	(467)	2,386
High Yield	3,352	2,895	456
Long Term (10yr +)	956	669	287
Intermediate (5-10yr)	2,300	706	1,594
Short / Intermediate (3-5yr)	946	644	302
Short (1-3yr)	1,070	410	660
National funds	5,194	2,585	2,609
New York	41	(41)	82
California	313	165	149

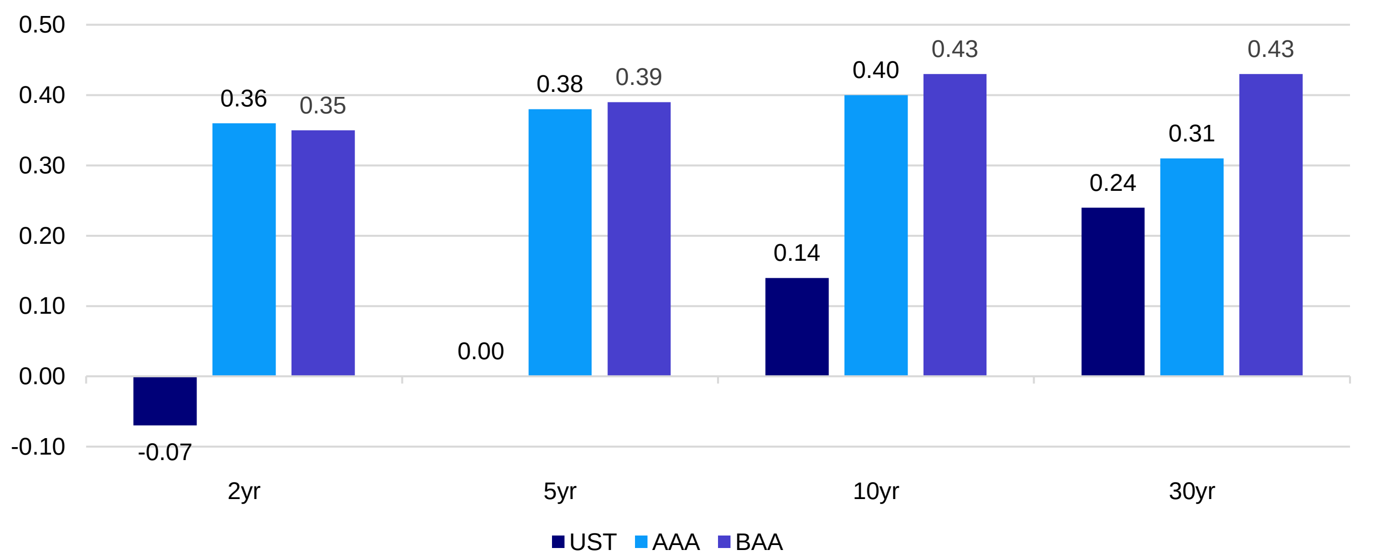
Source: Year to date LSEG Lipper Global Fund Flows, J.P. Morgan. Data refreshed on April 17, 2025. Note: Figures shown on this table are combination of weekly and monthly reporters.

30-day Visible Supply ($billions)



Source: 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 18, 2024 – April 18, 2025.

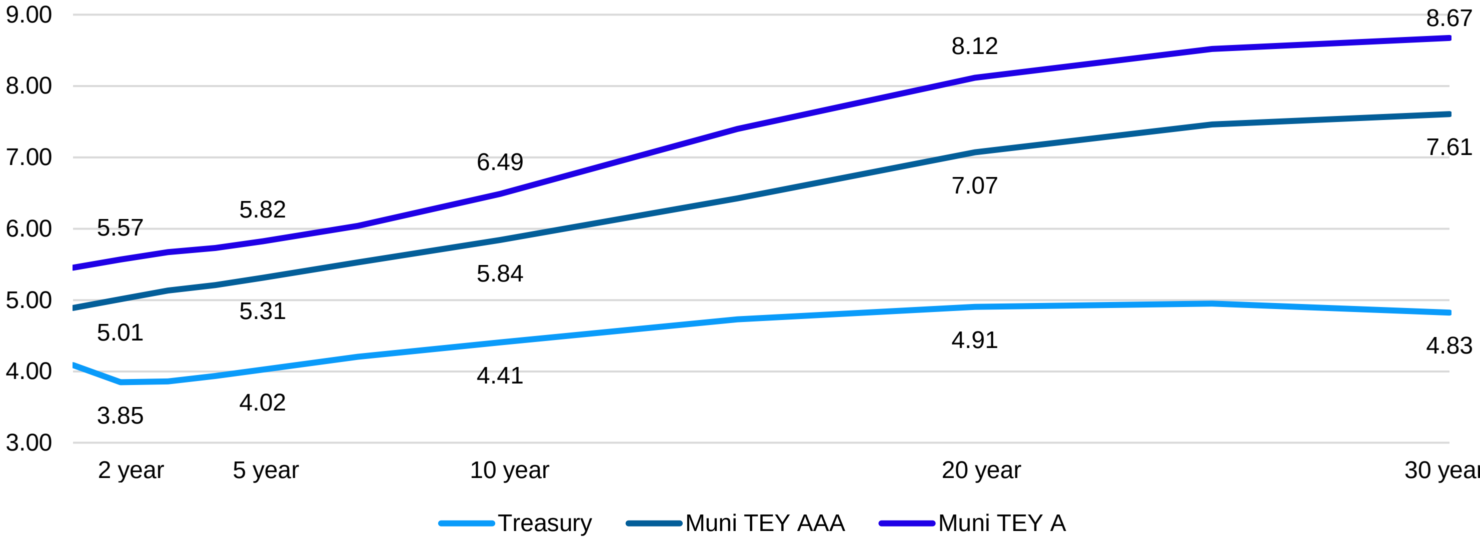
1-Month Yield Change 3/21/25 – 4/23/25 (% Change)



Source: Refinitiv MMD Curve, US Department of Treasury, from March 21, 2025 – April 23, 2025. 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.; https://ratings.moodys.io/ratings and select 'Rating Methodologies' 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.

Munis by the numbers

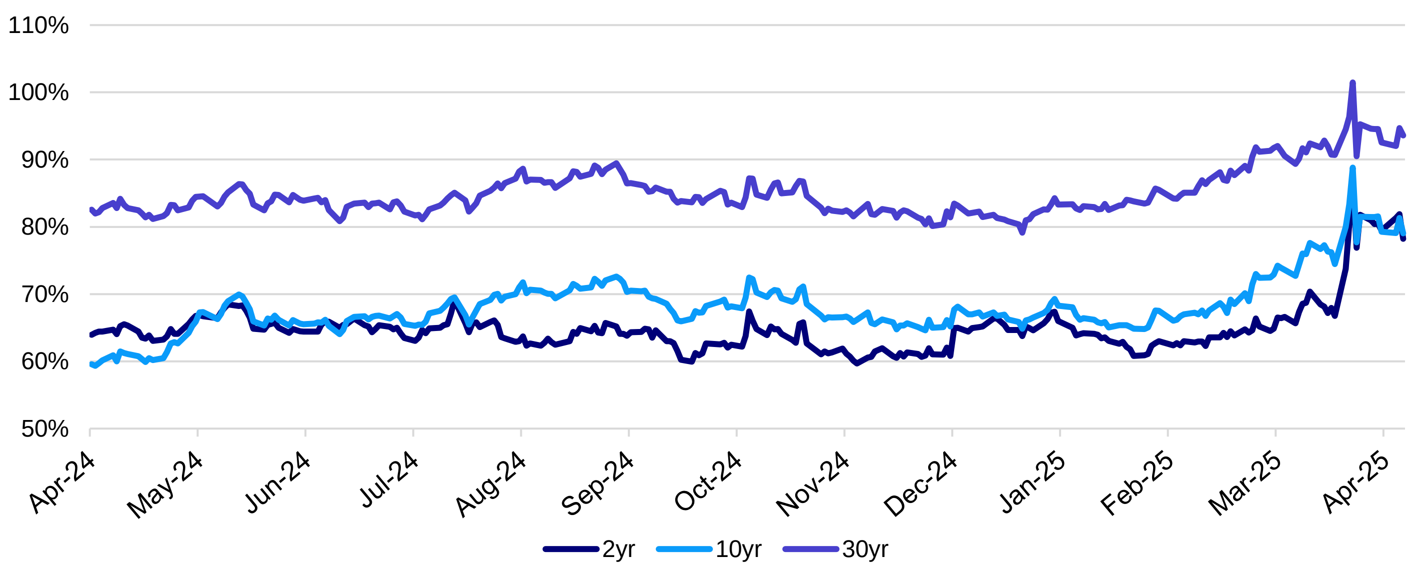
Current Muni Treasury Ratio and Tax-Equivalent Yields (%)



Term	US Treasury (UST)	Muni AAA	Muni A	Muni TEY AAA	Muni TEY A	Muni UST Ratio	Muni TEY UST Ratio
2 year	3.85	2.97	3.30	5.01	5.57	77.1%	130.3%
5 year	4.02	3.14	3.45	5.31	5.82	78.1%	132.0%
10 year	4.41	3.46	3.84	5.84	6.49	78.4%	132.5%
20 year	4.91	4.19	4.80	7.07	8.12	85.3%	144.1%
30 year	4.83	4.50	5.13	7.61	8.67	93.3%	157.6%

Source: Bloomberg as of April 21, 2025. TEY = Tax-Equivalent Yield. UST = United States Treasury. US Treasury is represented by the public obligations of the US Treasury. Treasurys 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. Muni AAA is represented by the Municipal AAA GO bond yield, a 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. The Muni TEY AAA is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni AAA yield. Muni A is the Bloomberg Municipal Bond A Index is an unmanaged index of the A-rated municipal bond market. The Muni TEY A is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni A yield. The Muni UST Ratio is the comparison of the Muni AAA vs. the yield on the US Treasury. The Muni TEY UST Ratio is the Tax-Equivalent Yield is assuming a top tax rate of 40.8% of the Muni UST Ratio. An investment cannot be made directly into an index.
Tax-Equivalent Yield is assuming a top tax rate of 40.8%, 37% federal tax rate and 3.8% net investment income tax (NIIT), effective Jan. 1, 2025. Irs.gov, as of October 22, 2024. Top marginal tax rate for single taxpayers with more than $626,350 in taxable income or couples with $751,600 or more. NIIT is the net investment income tax investment income for single taxpayers with more than $200,000 in taxable income or couples with $250,000 or more.

Municipal/Treasury Ratio



Source: Thomson Reuters TM3, as of April 23, 2025. US Treasury is represented by the public obligations of the US Treasury. Treasurys 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. 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. An investment cannot be made directly into an index.

A yield curve is a line that plots yields (interest rates) of bonds having equal credit quality but differing maturity dates. The slope of the yield curve gives an idea of future interest rate changes and economic activity.

Bloomberg Municipal High Yield Bond Index is generally representative of bonds that are non-investment grade, unrated or rated below Ba1.

Sources:

1. Thomson Reuters, as of April 15, 2025.
2. Bloomberg, as of June 30, 2024. Performance represented by the Bloomberg Municipal Bond Index, is an unmanaged index considered representative of the tax-exempt bond market. An investment cannot be made directly into an index. Past performance does not guarantee future results. Fed Raising Rates (2004-2006): bottom: 5/13/04, -5.29%; 18-months following bottom: 9.39%. Global Financial Crisis (2008): bottom: 10/16/2008 -11.22%; 18-months following bottom: 23.04%. Fear of Default Crisis (the 2010 crisis of confidence sparked by an unfounded fear that hundreds of billions of dollars' worth of municipal defaults were on the horizon): bottom: 1/17/11, -6.46%; 18-months following bottom: 18.53%. Taper Tantrum (2013): bottom: 9/5/13, -6.77%; 18-months following bottom: 12.75%. Trump Election Victory (2016): bottom: 12/1/16, -5.71%; 18-months following bottom: 6.00%. COVID-19 Pandemic (2020): bottom: 3/23/20, -10.94%; 18-months following bottom: 15.49%. Inflation Crisis (2022): bottom: 10/26/22, -13.42%; 18-months following bottom: 10.01%. Standard and Poor's, as of March 31, 2025.
3. Barclays Municipal Research, as of December 5, 2024.
4. Thomson Reuters, data as of March 31, 2025.
5. Bloomberg, as of March 31, 2025. Performance represented by the Bloomberg Municipal Bond Index, is an unmanaged index considered representative of the tax-exempt bond market. An investment cannot be made directly into an index. Past performance does not guarantee future results. Assuming a top tax rate of 40.8%, 37% federal tax rate and 3.8% net investment income tax (NIIT), effective Jan. 1, 2025. Irs.gov, as of October 22, 2024. Top marginal tax rate for single taxpayers with more than $626,350 in taxable income or couples with $751,600 or more. NIIT is the net investment income tax investment income for single taxpayers with more than $200,000 in taxable income or couples with $250,000 or more.

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 April 23, 2025, unless otherwise stated.

All data provided by Invesco unless otherwise noted.

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