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Active Management Could Serve Muni Bond Investors Well.

Last year was a decent one for muni bonds and related exchange traded funds. The Federal Reserve unveiling its first interest rate cuts in four years helped the cause. But with concerns mounting that the Fed may only cut once this year, catalysts for bonds, including munis, need to be derived from other sources.

Should the central bank be less aggressive than hoped on the monetary easing front, that could be a sign active management could be the way for advisors and investors to tap municipal debt in 2025. Enter the ALPS Intermediate Municipal Bond ETF (MNBD). One reason active muni strategies could take center stage this year is because income more than rate cuts could drive muni bond returns.

"We believe 2025 will be the year of the coupon, where income will once again be the main source of investor returns in municipals. Our view is that yields will stay elevated during the year amidst healthy economic growth, a data dependent Federal Reserve (Fed), and overall fiscal policy uncertainty," noted Goldman Sachs Asset Management (GSAM).

Muni Bonds ETF MNBD Could Have Multiple Tailwinds
There are multiple reasons active muni strategies such as MNBD could thrive in 2025. Those include the possibility of volatile rates and that lower-rated munis could outperform higher-quality counterparts. Active funds like MNBD could be more responsive to those themes.

"10-year municipal yields went along for the volatile macroeconomic ride by starting 2024 at 2.27%, followed by a climb to 3.11%, then to a low of 2.51%, then increasing to 3.14%, falling to 2.78%, before finally ending the year at 3.13%," according to GSAM. "A growing economy, solid credit fundamentals, and strong demand drove the BBB-rated and high yield portion of the municipal market to vastly outperform their higher rated counterparts."

Another reason active management could be the way to go with municipal bonds is the expected spate of new supply. GSAM estimates that to be $500 billion for 2025. On the bright side, demand for municipal bonds, including from advisors and investors seeking tax benefits, is expected to remain stout this year. That could add to the case for ETFs like MNBD.

"We believe demand from individuals may materially increase, particularly if money market fund and short-term Treasury yields decrease significantly as the Fed lowers its benchmark rate. We think bank demand will remain constrained with the corporate tax rate remaining at 21% given President-elect Trump's comments during the campaign, possibly moving lower," concluded GSAM.

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by Todd Shriber

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