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Pullback From Muni-Bond Could Be a 'Yellow Flag' After Market Losses.

- **Muni funds saw outflows this week after weeks of gaining cash**
- **Investors may be responding to worst January on record**

The municipal market's short-term future might be on shaky ground.

Mutual funds that focus on state and local government bonds saw investors pull out about $443 million in the week leading up to Wednesday, breaking a five-week streak during which they continued to pour in funds, according to Lipper US Fund Flows data. Exchange traded funds lost $30.3 million this week, its first negative since April 2017, according to CreditSights analyst Pat Luby.

"It's a yellow flag, not a red flag yet," Luby said. "Inflation news has provided a dose of reality for the market."

The outflows come after municipal bonds slid amid speculation that the pace of the economy will fuel higher interest rates, sending the securities to their worst January loss since at least 1981, according to the Bloomberg Barclays index. Analysts have speculated that the loss may cause a pullback by individual investors, who are the largest holders of municipal bonds.

Greg Kaplan, the director of fixed income for City National Rochdale, said such investors are "historically reactionary." After January's performance, he expected flows to worsen as investors saw their account statements.

Jeff Lipton, managing director for Oppenheimer, said some investors have been cautious about state and local bonds because of concerns about the ripple effects of the federal tax overhaul enacted in December. He said outflows are a result of market uncertainty, especially looming interest rate hikes from the Fed, though he expects that the retreat from municipal funds will only be temporary.

"Even with disproportionate volatility, it will be positive for the year," Lipton said. "There will just be intermittent periods of negative flows."

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