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Even Cash Flooding Muni Market Can't Stop Worst Loss Since 2018.

- **September was worst month for returns in almost two years**
- **Marks a stepback from rally that roared this year as rates cut**

Not even a continuously flowing spigot of investor cash was strong enough to prevent the $3.8 trillion municipal-bond market from snapping this year's rally.

State and local government debt is headed toward a 0.82% loss in September, the first down month of the year and the biggest decline since January 2018, according to Bloomberg Barclays indexes. The drop came as Treasuries sold off and as new debt sales weighed on performance, with supply of bonds 46% higher than it was the same month a year earlier as governments raced to capture lower interest rates, according to data compiled by Bloomberg.

Barclays Plc strategists led by Mikhail Foux said they're "cautious near-term," given that expectations for a rate cut in October may be too optimistic and the market could stay volatile.

The tax-free securities are still headed for a 6.7% return this year, the best year for the asset class since 2014. Investors have plowed billions into municipal-bond mutual funds as investors seek to reduce their tax burden.

The pullback has left state and local government debt cheaper, relative to Treasuries, than it was earlier this year. Ten-year tax-exempt debt is yielding about 88% of Treasuries, up from as little as 71% in May. That was the lowest that gauge of relative value had hit since at least 2001, indicating that valuations were historically high.

Typically, municipal bonds cheapen compared with Treasuries in September and October before getting a boost from investors positioning themselves for the next year, they said in a Sept. 27 note.

"The story will likely repeat itself in 2019," the strategists said.

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