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Municipal Bond Market Update - September Edition

On August 27, Federal Reserve Chairman Jerome Powell announced a major policy shift, stating that the central bank will allow inflation to run hotter than the Fed's 2 percent target in order to support the labor market and the economy. "Many find it counterintuitive that the Fed would want to push up inflation" Powell stated. "However, inflation that is persistently too low can pose serious risks to the economy."

Muni Market Performance

The municipal market concluded its streak of positive returns in August, marking the end of the three-month recovery that began in May. The Bloomberg Barclays Municipal Bond Index returned negative 47 basis points (0.47 percent) for the month, leaving municipal-bond prices broadly lower. In the final three trading days of the month, muni-bonds fell 17 basis points (0.17 percent) following Federal Reserve Chairman Jerome Powell's speech at the first virtual Jackson Hole Conference. The Jackson Hole Conference is an annual economic symposium, sponsored by the Federal Reserve Bank of Kansas City since 1978 and is held in Jackson Hole, Wyoming. It was during the virtual symposium that Fed Chair Jerome Powell announced the policy shift to "average inflation targeting," spurring concerns of higher future inflation. The comments pushed rates higher on longer-term U.S. Treasuries, with municipal bond yields following suit.

Longer-dated muni-bonds were particularly vulnerable to the Fed's announcement as those with maturities greater than 22 years posted a negative 0.78 percent return for the month. Municipal bonds towards the front end of the curve were largely unchanged, with those in the one to five-year maturity range returning negative 0.02 percent. Intermediate municipals with five-to-ten year maturities returned a negative 0.27 percent in August.

While investment-grade muni bonds ended their streak of positive monthly returns, higher-yielding credits continued to march higher. The Bloomberg Barclays Muni High Yield Index returned a positive 0.26 percent. High yield municipal bonds have outperformed their investment-grade counterparts each month since May but remain behind year-to-date. Within investment grade, Baa-rated municipals were the best performing rating category, returning negative 0.04 percent, but have underperformed higher-rated peers year-to-date. AAA-rated municipal bonds returned negative 0.63 percent in August.

Supply & Demand Situation

August issuance was comparable to the same month last year, however, year-to-date issuance remains elevated at 41 percent higher year-over-year. Taxable municipal issuance continues to drive the new issue supply volume. Advanced refundings have led year to date taxable issuance to make up nearly 30 percent of the year's total municipal supply. Historically, taxable issuance has made up 5 to 10 percent of the total supply. The increase in taxable issuance is even more pronounced when comparing current issuance levels to the prior year, marking an increase of over 250 percent year-over-year.

Demand continues to remain strong with municipal funds posting their 16 weeks of consecutive inflows. However, investor flows into municipal bond funds slowed towards month-end as Congress broke for recess without agreeing on phase 4 stimulus measures. Negotiations appear likely to continue into the fall as investors search for clarity around the size and scope of any additional packages.

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