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What The Election, Pandemic May Mean For Municipal Bond Investors.

Tax-exempt municipal bonds continue to trade favorably to Government Bonds as the Federal Reserve and Treasury support most fixed income markets with the exception of municipals.

Unless, of course, you count the little used $500 billion Municipal Liquidity Facility (MLF) created by the Federal Reserve Board in conjunction with resources provided in the CARES Act at the beginning of the pandemic. New York Metropolitan Transit and the State of Illinois are the only two issuers to participate to date in the MLF. So, even though interest rates are at historically low rates, municipals are offering an incremental yield advantage with the bonus of tax-exemption when compared to Treasurys and Agencies as a consequence of the Federal Reserve Board's unprecedented intervention in the fixed income markets.

Even if Congress doesn't act to assist state and local governments with additional fiscal aid, we should expect to see many types of municipals continue to outperform Treasurys and Agencies. Keep in mind however that tax-exempt bonds financing convention centers, transit facilities, senior living, private post secondary education, and economic development have been most affected by the economic contraction caused by the pandemic. Property tax supported general obligation bonds and essential fee for service revenue bonds consequently have been the strongest muni assets through the pandemic.

As Congress has stalled in its attempts to pass additional support for state and local governments through either the Democrats' HEROES Act ($3 trillion) or the Republicans' HEALS Act ($1 trillion), issuers and investors are looking to the November 3rd election to provide guidance on future fiscal policy relief. And with presidential and vice presidential debates and a Supreme Court justice appointment confirmation hearings absorbing most of Washington's oxygen, it isn't likely Congress will act anytime soon on state and local government fiscal relief.

Municipal bond investors have much at stake in this election. Financial matters are very much in play as both parties are promoting shifting policy emphasis on taxes, trade, monetary intervention, fiscal legislation, and social justice. The direction our economy and society take as a consequence of this election will long be felt.

Most importantly, keep in mind that all other things being equal, increasing federal or state taxes will make tax-exempts more valuable while trade and immigration policies will influence local economic development and expansion or contraction. In the absence of fiscal relief it will become even more challenging to evaluate municipal credits in a timely manner. And don't lose sight of the fact the Fed will eventually have to adjust monetary policy to account for the aggressive intervention exercised during the pandemic.

There is no precedent for the level of government involvement in today's fixed income markets. The consequences of this election and the policy steps taken in 2021 will have a powerful influence on both investor returns and issuer borrowing costs. Investors and issuers can however find safe harbor in the fundamental security of what municipal bonds finance – streets, clean water, schools, public safety – knowing these fundamentals will persist while rewarding investors with predictable, though perhaps unsatisfying absolute, rates of return and offering state and local government issuers historically low costs of borrowing.

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