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Cracks Form in the Fragile Muni Bond Market.

In the long run, fundamentals matter in all financial markets.

Stocks can be overvalued for a time. But eventually a price decline or a surge in earnings reverses that condition.

Bonds can also be overvalued or undervalued. In these markets, analysts focus on cash flows instead of earnings to determine value.

Just as in the stock market, cash flow is measured with inflows and outflows.

In the municipal (muni) bond market, inflows consist of tax revenues. Outflows are expenses for government services.

A security could be undervalued, for example, if a tax increase is about to be implemented, that will ensure a state can repay its debt. If revenues decline suddenly, the bond could be overvalued.

Over the next few years, inflows for states should fall. The chart below shows that revenue is expected to drop by more than 11% in 2021.

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