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Municipal Bond Market Update - November Edition

Investors are closely watching U.S. election results as expectations for a clear outcome dwindle.

As votes continue to be counted, investors are paying close attention to states such as Michigan, Pennsylvania, and Wisconsin. Market participants fear a contested election due to the potential for increased volatility amid concerns of a drawn-out count. The election has shifted attention toward mail-in ballots and final tallies, away from the groundbreaking quarter of economic growth reported last week.

On October 29, the Bureau of Economic Analysis (BEA) released U.S. GDP for the third quarter of 2020. The BEA estimates that real GDP accelerated at a record 33.1 percent annualized rate as the economy recoups lost ground from the first half of the year. The historic recovery reflects “continued efforts to reopen businesses and resume activities that were postponed or restricted due to COVID-19” the commerce department reported.

Despite the U.S. economy’s blockbuster rebound, election uncertainty and further stimulus bill delays led to a spooky October for investors as broad-based equity and fixed income markets ended the month lower.

Muni Market Performance

Municipals were not exempt from the month’s frightening performance as the broad market, measured by the Bloomberg Barclays Municipal Bond Index, concluded the month 0.30% lower. Despite tax-exempt’s lackluster month, the asset class outperformed taxable bonds with Treasuries ending the month 0.94% lower and the Bloomberg US Gov/Credit Index finishing 0.60% lower.

The AAA municipal benchmark yield curve continued its steepening trajectory, with yields in the two-year range concluding the month 4.8 basis points (bps) higher while ten and thirty-year yields ended 8.2 and 9.7 bps higher, respectively. As evidenced by the steepening yield curve, longer dated muni bonds (22+ years to maturity) lagged shorter dated peers for the month, producing a total return of negative 0.43%. Municipals with maturities in the one to five-year range led performance for the month, returning 0.15%, while intermediate term munis in the five to ten-year range ended 0.26% lower.

October marks six-straight months of high-yield (below investment grade) muni outperformance. The lower quality asset class ended the month in positive territory with a total return of 0.18%, according to the Bloomberg Barclays Muni High Yield Index. Despite the streak of positive relative performance, lower quality paper remains behind year-to-date, struggling to recoup losses from March’s drawdown. Through the October month end, the Bloomberg Barclays Municipal Bond Index has returned 3.02% for the year whereas the Bloomberg Barclays High Yield Municipal Bond Index has returned 0.54%.

Supply & Demand Situation

Municipal issuance saw a record setting month as issuers seek to capitalize on historically low interest rates. October's almost $70 billion in new issue deals came to market against the backdrop of political uncertainty as municipalities rushed ahead of the election. Year-to-date supply was 26.6 percent higher than the same time last year, amounting to a total volume of nearly $415 billion. Tax-exempt municipals continue to trade favorably despite the heightened political discourse. The two-year muni-to-Treasury ratio, which represents muni yields relative to Treasuries, ended October at 129 percent while the ten- and thirty-year ratios both ended the month at 107 percent.

As final tallies are counted in the U.S., municipal bonds may continue to see volatility as investors search for clarity around potential income tax changes and additional stimulus measures.

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