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Munis Join Selloff, Closing a Refuge From Mounting Bond Losses.

- **30-year benchmark muni bonds rose the most in three weeks**
- **Marks a shift for market that eked out gains this month**

The state and local government bond market is losing its status as a temporary refuge for fixed-income investors.

Municipal bond yields surged along with Treasuries Thursday after Federal Reserve Chair Jerome Powell said the central bank will keep interest rates low until the economic recovery is evident, stoking concerns about rising inflation.

That marks a shift for the $3.9 trillion market, a slow-moving province of buy-and-hold investors who have continued to pour a steady stream of cash into mutual funds. Before Thursday, the securities had delivered positive returns this month — a contrast to the losses piling up in the corporate debt and Treasuries markets.

“Over the past two days, municipal yields have begun to react to sizable year-to-date increases in yields in the broader U.S. fixed-income markets,” Peter DeGroot, head of municipal research and strategy for JPMorgan Chase & Co., said in an interview. “The outlook for fundamentals is good. But the muni asset class is expected to under-perform given the selloff in the broader U.S. fixed income market.”

Yields on benchmark 30-year tax-exempt bonds rose 7 basis points to 1.8%, the steepest jump in three weeks, according to Bloomberg’s BVAL indexes. Those on 10-year debt rose about 7 basis points to 1.1%.

The rising yields could jeopardize the influx of cash that had helped to prop up prices this year as investors added an average of $2.3 billion to municipal debt funds each week, according to Investment Company Institute data compiled by Bloomberg.

That influx had come as states and cities were poised to receive some $350 billion in federal aid to contend with the financial impacts of the pandemic, significantly easing the risk of deep credit rating cuts or mounting distress. The market also stood to gain from President Joe Biden’s push to raise taxes on the highest earners, which would likely increase demand for federally tax-free bonds.

Analysts have been watching closely for signs that investors are starting to pull back. The individual investors who are the biggest owners of municipal bonds tend to act in concert during down markets, leaving mutual funds typically facing long periods of cash withdraws known as an outflow cycle.

Until Thursday, the muni-market had been little changed in 2021, with gains earlier this month paring their losses for the year to 0.35%, compared with the 4% drop for Treasuries, according to Bloomberg Barclays indexes.

Despite the improving financial fundamentals of state and local borrowers, such a retreat could exert a drag on the market's performance, DeGroot said. "Municipal funds are susceptible to outflows in periods of rising muni rates and negative fund performance," he said.

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