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‘Can’t Go Up Forever’: Muni Bonds See First Loss Since February.

- **Bloomberg benchmark shows tax-free debt down 0.37% in August**
- **Market still up for the year, beating Treasuries, corporates**

State and local government debt is poised for the first monthly drop since February, stepping back from a rally that made it one of the best performing corners of the bond market.

The securities have posted a loss of 0.37% since the start of August, according to Bloomberg’s benchmark index, as yields rose on speculation about when the Federal Reserve will start tightening monetary policy.

The decline is a shift after five straight months of gains that have allowed tax-exempt bonds to eke out a positive return so far this year, in contrast the overall losses for both Treasuries and investment-grade corporate debt.

“The market just can’t keep rallying,” said Vikram Rai, head of municipal strategy for Citigroup Inc. He said the returns are not “deeply negative,” so the dip isn’t likely to shake up investor sentiment or cheapen heady valuations that have frustrated investors for much of the year. “August is just a minor correction.”

The advance this year came as investors plowed record amounts of cash into mutual funds, fueling high demand for the bonds. That helped hold down yields and earlier this year pushed a key measure of valuations to an all-time high. That influx has continued to hold up despite the price retreat.

James Iselin, a portfolio manager at Neuberger Berman Group, said that tax-exempt bonds have been extremely expensive relative to Treasuries and it’s natural to see “a modest pullback” as trading slows at the end of the summer.

“Things can’t go up forever,” he said.

“A lot of people in the market aren’t upset to see a little backup in yields off these levels,” he added. “The market got a little bit tired and, with Treasuries stopping the huge rally that they had and going the other way, it makes sense that munis came a little off their highs.”

Bloomberg Markets

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August 31, 2021, 11:33 AM MDT