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Market Volatility 'Always Creates Better Value': BlackRock Head of Muni Bonds Group

Peter Hayes, Head of BlackRock's Muni Bonds Group, joins Yahoo Finance Live to discuss Fed policy and how it will affect fixed income investors and municipal bonds.

Video Transcript
– Welcome back. We want to dive deeper into the market reaction and specifically the fixed income market reaction to the Fed's latest statement and press conference. And for that, we have Peter Hayes, Head of BlackRock's Municipal Bonds Group joining us now.

Peter, thanks for joining us again. I went back through Powell's press conference from yesterday. And he used the word "uncertain" seven times over the course of that hour with regard to the uncertain economic outlook and future policy path forward on interest rates and the balance sheet. What do you think the bond market is pricing in right now in terms of what specifically the Fed may do this year?

PETER HAYES: Hello, Emily. Thanks for having me back. I appreciate it. Yeah, I think uncertain is the way to describe it. I think the Fed is uncertain as all of we are. We don't know what's going to happen with the virus, the economic bounce back, will there be future variants that will derail the economy. There's just so many things we don't know.

And he used the word, I think, "steadily and transparently" to describe the policy going forward. And I think the market needs to take that at face value. You can argue otherwise, but the equity markets have received an awful uplift from both accommodative fiscal and monetary policy over the last couple of years. Fiscal policy is dissipating and future programs are a bit uncertain. And the monetary policy they have to normalize at some point.

I think they would love to get back to a Fed funds rate that they had in 2019, which is in that 2 to 2 and 1/2 range. That's not going to happen anytime soon. They're walking a tightrope. It's a very delicate situation there. And you could see the reaction of the equity markets when they talk about tightening policy and hiking rates. So I think they're going to go very slow. They're going to see what the market reaction is, how the economy responds, what the data tells them, and then they'll act accordingly.

– Peter, when you say uncertainty and don't know, I think many of us as investors would take uncertainty and don't know from people at BlackRock much better than we would take it from anybody else. And I bring that up because as you head the muni bonds group, looking at this environment, a lot of people, the simple question we have is, what do I do with the cash I'm sitting on? I don't want to go into US treasuries because people don't get much of a return. So we look at muni bonds.

And yet I remember in a note, I think it was last month you pointed out, there's going to be a whole lot of maturity of tax exempt muni bonds coming to market or finishing in the next year or two. So how do we as investors position? And we probably come to someone like you at BlackRock to guide us so that we can make some money because the Fed makes a lot of people nervous.

PETER HAYES: Yeah, the Fed is making a lot of people nervous. And we see that. We see that in outflows. We've had, in the muni industry, we've had 45 straight weeks of inflows into municipal mutual funds. Last week, we were down about $280 million. This week, we're actually setting up for about $1.4 billion outflow, which will be the biggest since April of 2020.

So there is a lot of uncertainty on the part of investors, what to do. Financial assets, generally, whether it's equities or bonds, are not doing well so far to start the year. But I think the important thing to remember is whenever you see volatility, whenever you see down markets, that always creates better value. Of course, the depth of the sell-off will tell us how much value is created.

We've seen in munis yields since we last spoke at them. I think the yields are probably about 40 to 50 basis points higher. So prices have gone down, yields higher. That's good news. But I think we have a little bit more to go. I think the skepticism on the part of investors, what the Fed hiking rates will mean for the economy, what it will mean for housing what will it mean for credit card debt and spending, et cetera. So again, I think we have a little ways to go before we get some clarity on that.

It's not going to last all year. My guess is that a lot of this volatility increasing interest rates will be front end loaded, meaning it will probably be largely the first quarter of this year. Munis, no exception. We've seen the index is now down negative 2%. And last year, it was one of the few bright spots in fixed income markets returning about 1 and 1/2%. So we're sharing in the pain of rising rates, but ultimately, it does create better value.

So I think the short answer to your question, Adam, is I think we have to sit in cash. Be patient just a little bit longer.

– And when we think about fixed income more broadly, how do municipal bonds typically perform relative to other fixed income asset classes during a Fed rate hiking cycle? And do you expect that relative performance to be the same this year versus in past cycles?

PETER HAYES: I love that question. Great, great question because I think it's often lost on investors that when rates rise, when we're in a Fed hiking cycle, municipal bonds, because of their structure, because of their nature, tend to outperform other fixed income assets. And we saw that last year. I mentioned the 1 and 1/2% positive return. Not stellar. But when you look at other areas of fixed income, whether it be treasuries or corporate bonds, they outperform last year and the same holds true this year.

Even though we're down about 2%, treasuries are down more, corporate bonds are down more. So if you want to own some fixed income and a little bit of defense, munis are a good place to be. I think it's sort of an unknown feature of munis and rising rate environments.

– When we look forward to the March meeting, is any kind of language that you expect to hear from Jay Powell? We know we're going to get that first liftoff. That's what they've set us up for. But is there something that we might have missed just as average listeners to that press conference?

PETER HAYES: The one thing perhaps is maybe a little bit more clarity on how many tightenings they might undertake in 2022. He sort of left the door open a little bit, I think, at the conference yesterday. I think a little more clarity on that in March would probably give the markets a little bit of confidence and settle some of the volatility that we're seeing.

– All right. Peter Hayes is Head of BlackRock's Municipal Bonds Group, and we always appreciate having you on.

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