
Unprecedented January Muni-Market Losses Deepen on Fed Worries.

- **Bloomberg state and local bond index declines 1.46% this month**
- **Muni market on track for worst January performance since 1980**

The $4 trillion muni market, often a haven when other markets tumble, is suffering through its worst January on record as investors grow skittish about the prospect of Federal Reserve interest rate hikes.

The Bloomberg U.S. municipal bond index has fallen 1.46% this month through Monday, and is on track for its worst January performance in records dating back to 1980. Muni bonds often perform well in the first few weeks of the year, because investors usually have money to put to work thanks to year-end interest and principal payments, and states and cities often don't sell much in the way of new securities. Before 2022, the index had posted a loss only six times in January over four decades.

The weakness underscores how widely the expected Fed tightening cycle is hitting markets. Returns like these could jolt worried investors, said Nisha Patel, a managing director for Parametric Portfolio Associates, which holds $43 billion in muni assets.

"In the past during sharp moves in rates, retail investors have panicked and have created an outflow cycle," Patel said. "However, it is too soon to say yet if that comes to fruition."

Munis are hardly the worst-hit part of the bond market now. U.S. investment-grade corporate bonds have dropped 2.8% this year, and the Bloomberg U.S. Aggregate index is down 1.9%. And in stocks, it's far worse, with the S&P 500 down 7.4% on a total return basis through Monday's close.

Investors are now trying to figure out where to deploy cash, and whether to buy munis, said Erin Ortiz, managing director for municipal credit at Janney Montgomery Scott.

"Pretty much everything is red," she said.

On the one hand, the bonds offer higher income than they did just a few months ago: the yield for 10-year AAA muni benchmark securities has climbed about 30 basis points this month to 1.34% on Tuesday, the highest since May 2020.

But stock markets are whipsawing day to day and Treasury yields have fluctuated wildly as well. Bonds could broadly get hit as the Fed starts lifting rates and takes other steps to combat inflation. The central bank wraps up its two-day meeting on Wednesday.

Concerns about that possibility may be among reasons investors this month pulled cash out of municipal-bond mutual funds for the first time in 10 months, with $239 million withdrawn during the week ended Jan. 19, according to Refinitiv Lipper US Fund Flows data. The outflow ends 45 straight weeks of gains.

“There are several factors driving YTD performance, but the biggest impact is a more hawkish Fed,” James D’Arcy, a senior portfolio manager for the municipal bond desk at Vanguard Group Inc., which holds about $267 billion of munis, said in an email.

Ortiz and Patel both noted that the outflows could be temporary.

“Cash may quickly come into the market,” said Patel. “There is a lot of cash on the sidelines to put to work.”

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