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[Municipal Bond Investors' Fears Turn to Rising Tates.]

- After municipal government finances weathered the COVID-19 pandemic, thanks to federal government aid and better-than-expected revenue during the pandemic, municipal bond investors are now concerned about interest rates rising, the *Wall Street Journal* reports.
- As the Federal Reserve starts removing pandemic stimulus measures, yields on state and local debt are rising. And in bond markets, yields move inversely to bond prices, so rising yields indicate falling bond prices.
- “Credit has just not been the boogeyman that anyone thought it might be,” Matt Fabian, a partner with Municipal Market Analytics, told the WSJ. “The real risk in the sector, at least for now, is rates.”
- Rising rates make outstanding debt less attractive to investors, because, by contrast, newly issued bonds offer better returns. Benchmark 10-year, triple-A general obligation (GO) bonds were trading at 1.65% on Friday, up from 1.04% a the beginning of the year, WSJ said, citing Refinitiv MMD data.
- So far this year, investors have pulled a net $6.7B from municipal bond funds, the most consistent outflows since March-April 2020, when early in the pandemic investors worried that local governments would have a hard time paying their bills.
- That plunge in confidence pushed yields on 10-year tax-exempt triple-A GO munis to a high of 2.8% on March 23, 2020, while 10-year Teasurys yielded 0.75%.
- By contrast, this year muni yields are rising along with Treasurys as investors try to divine global market volatility and word leaders’ actions.
- “It’s sometimes very hard to read the tea leaves when you’ve got geopolitical risk, COVID, a Fed that is going to be raising rates and inflation that may or may not be transitory,” Cynthia Clemson, co-director of municipal investments at Eaton Vance Management, told the WSJ. “Municipal credit is in good shape,” she added. “Everyone’s trying to think ‘What are rates going to do?'”
- In the past six months, the Vanguard Municipal Tax Exempt Bond ETF (NYSEARCA:VTEB) has dropped 4.0% and the VanEck High-Yield Muni ETF (BATS:HYD) has fallen 6.2% vs. the S&P 500’s -0.5% decline as seen in this chart, while the iShares IBoxx $ Investment Grade Corporate Bond ETF (NYSEARCA:LQD) declined by 8.3%.
- For the week ended Feb. 16, money market funds (-$41.9B), taxable bond funds (-$8.1B), and tax-exempt bond funds (-$1.3B) suffered significant outflows, according to Refinitiv Lipper data. Equity funds (+4.8B) were the only macro group that brought in new capital during the week.

Seeking Alpha

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