Munis at Risk of Rough March as Tax Season Seen Spurring Sales.

- **Investors with big capital gains often dump munis to pay bills**
- **March and April are weakest months for inflows: Barclays**

The $4 trillion municipal bond market may be in for a rough road the next couple of months, after a brief respite from its 2022 losses amid haven buying fueled by the Ukraine conflict.

March and April are typically the weakest months for muni-fund inflows because investors tend to unload some holdings to pay tax bills ahead of the mid-April U.S. filing deadline, Barclays Plc strategists say.

The phenomenon may be more pronounced this year because the biggest bouts of tax-induced selling come in years after strong stock market performance, according to Barclays. The S&P 500 Index gained about 27% in 2021 and finished the year near record highs. By selling bonds now, investors can also take advantage of the market's 2022 declines to harvest any tax losses.

"Those two things could make March relatively ugly in terms of technicals," said Mikhail Foux, head of municipal strategy at Barclays. Add potential volatility because of the war in Ukraine and the lead-up to the Federal Reserve's widely expected move to start lifting interest rates next month, and the market could be in for a rocky stretch.

Investors have already pulled almost $8 billion from municipal-bond funds this year, according to Refinitiv Lipper US Fund Flows data, driven by elevated inflation and a hawkish Fed. Investment-grade municipal bonds have lost 3% in 2022, on pace for the worst start to a year since 2008, according to the Bloomberg U.S. Municipal Index. The broader U.S. bond market is down 4.1% in 2022.

There have been past periods of cash exiting munis during abrupt bond-market selloffs, or when concern about municipal credit was prevalent, such as in the aftermath of the 2008 credit crisis. But tax-induced selling has been the spark for multiple outflow cycles over the past decade or so, according to Barclays.

Since 2010, investment-grade muni funds have had 11 periods of outflows, and six started in the stretch from January to April, according to the bank. The biggest such episodes took place in 2011, 2013, 2015 and 2018, following a strong performance by risky assets, according to Barclays.

"Last year's performance was great pretty much across all assets," Foux said.

The muni market is also set to see a key source of demand ebb.

The amount of cash investors will receive from municipal bond payments in the next three months will be "significantly" less than February, according to CreditSights. The research firm estimates bondholders will receive $22.7 billion in principal and interest payments in March, compared with

$34.2 billion this month. It estimates April and May payments at $16.3 billion and $22.2 billion, respectively.

“If we see a continuation of even a dribble of outflows from mutual funds and then you’ve lost the influx of cash and reinvestment demand, it’s just another headwind,” said Pat Luby, CreditSights senior municipal strategist.

Bloomberg Markets

By Martin Z Braun

February 25, 2022