
Munis Shed Sleepy Reputation With Biggest Swings in 10 Months.

- **Gauge of 30-day volatility reaches highest since early April**
- **Retail buyer base has 'inherent fear of rates rising'**

The often-sleepy municipal-bond market is increasingly turbulent in the lead-up to the Federal Reserve's widely expected move to start lifting interest rates next month.

A gauge of 30-day volatility tied to Bloomberg's municipal-bond index is the highest since early April 2021. It's coming amid a global bond selloff that's driving the municipal market to a second straight monthly decline, for a 3.3% loss to start the year, according to Bloomberg indexes.

The swings are an opportunity for some investors, but are spooking others: Investors pulled about $1.3 billion from muni mutual funds during the week ended Wednesday, Refinitiv Lipper US Fund Flows data show.

Nicholas Foley, a portfolio manager at Segall Bryant & Hamill, said the market could see volatility climb even more as the Fed begins hiking rates. Municipals are especially vulnerable because they depend on retail buyers, and there's an "inherent fear of rates rising always," he said.

UBS Group AG strategists say the muni turbulence may persist until calm returns to Treasuries, where a measure of volatility reached the highest since March 2020 this month. Benefiting in part from their haven status amid rising geopolitical tension, Treasuries have fared better than munis to start the year, losing about 3%.

For Foley, municipals are still relatively expensive compared to Treasuries, leaving them more at risk of a selloff. Liquidity in the market is "thin," and when investors put bonds out for sale there can be few bids, he said.

"I'm a little surprised they've held as well as they have," he said.

Supply Threat

The market could also see supply start to increase, which could further weigh on performance. Barclays Plc strategists led by Mikhail Foux said the market remains vulnerable.

"Fund outflows and rate volatility have not been conducive for risk-taking; if supply picks up, munis may underperform even more," they said.

Still, investors aren't all bemoaning the volatility. Foley has been selling into the short end of the market, where demand has stayed strong as investors look to shield themselves from higher interest rates.

Meanwhile, he's bought long-duration debt that has cheapened. Those securities have been hit hard because that area of the market is dominated by institutional investors like mutual funds that are dealing with outflows, he said.

“For a smaller active manager, it’s much easier to find value and add value in these types of markets,” he said.

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