
Muni Investors Find Shelter From Volatility in Short-Term Bets.

- **Short duration muni bonds outperforming broader market**
- **Muni bond losses this year on track to be worst since 1994**

Municipal bond investors are finding shelter in shorter-duration securities as they wait out what's shaping up to be the worst quarter for munis since 1994.

The muni market has posted a loss of 4.9% this year, with the 10-year benchmark yield hitting the highest mark since the pandemic-induced tumult of March 2020. But some market participants are seeking relief at the shorter end of the curve.

Bonds with maturities of one, three and five years have lost just 1.16%, 2.65% and 3.88%, respectively, outperforming the broader market in 2022.

Robert W. Baird & Co. was underweight five-year munis last year, but thinks yields have risen enough there in recent weeks to make them worth buying now. The yields are higher and the duration is relatively low, giving them some protection against rising rates.

"There's been a lot of activity in that five-year area," said Gabriel Diederich, a portfolio manager at Robert W. Baird. "We want to look at where there's been an adjustment in valuation because that's where we can find a lot of opportunity."

Issuers are feeling the impacts of the underperformance at the long end as well. In response, they've either pushed pause or simply dealt with wider spreads, according to Kimberly Olsan, senior vice president of municipal bond trading at FHN Financial.

For example, the Dormitory Authority of the State of New York is indicating spreads of 130 basis points to the 30-year high-quality benchmark for a $3 billion deal scheduled Tuesday. That's roughly 50 basis points wider than what authority issued in December 2021 for a similar structure, Olsan said.

"Yield volatility is expected to give buyers similar, wider spreads in upcoming issues," she added.

Munis have weakened along with other bond markets as rising inflation pressures the Federal Reserve to tighten the money supply, a process expected to start on Wednesday with a quarter point hike. Investors have been pulling their cash from the municipal market for nine consecutive weeks, the longest stretch since 2018, according to Refinitiv Lipper.

Olsan said she's keeping an eye out for stability in yields and a slowdown in the robust secondary market, where some fund managers have been forced to sell to meet redemptions, as signs of a return to normalcy. That and an end to the outflow cycle, Diederich added.

"It's the demand side that's really dictating valuations," Diederich said. "The broader trend of outflows, certainly from open-end funds, which are the big gorilla in the room, has not been positive."

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