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## Muni Bonds Close Worst Quarter Since 1980s Down More Than 6%.

- **Rising rates increase chance of further short-term decline**
- **Some analysts see potential for pickup in demand on valuations**

The municipal-bond market is ending its worst quarter in about 40 years with a 6.4% loss, a dramatic pullback for an asset class that investors favor for its stability.

The loss so far this year is in line with bonds globally as central banks increase interest rates to combat the fastest inflation in decades. The municipal market is still underperforming U.S. Treasuries, heightening investor concern.

“We need this quarter over with,” said Dan Solender, head of municipal debt at Lord, Abbett & Co.

The selloff has wiped $108 billion of market value from Bloomberg’s municipal index since the start of 2022. Outflows from mutual funds have persisted, creating intense selling pressure in the secondary market for municipal securities.

The amount of bonds out for bid stood at $1.2 billion on Wednesday, a level not see in all of 2021, according to Bloomberg data.

“It’s finally sinking in — investors now believe that rates are going higher,” said Chris Johns, a managing director at Davidson Fixed Income Management. Retail investors, the core muni buyer base, have an “itchier trigger finger” when they see that interest rates are set to rise, he said.

Analysts have begun highlighting cheaper valuations in the municipal-bond market as an opportunity for new buyers. Thirty-year AAA municipals offer about 106% of the yield of comparable Treasuries, the highest since late 2020, according to data compiled by Bloomberg. That gauge of valuations, known as the muni-Treasury ratio, was as low as 67% in June 2021.

Solender said the market is seeing a “strange” shift from conditions just a year ago, when interest rates were about 100 basis points lower and cash was flooding into the market. Now, the credit conditions of municipalities has improved — but interest rates have soared. Higher yields should make munis more appealing to buyers, he said.

Morgan Stanley strategists led by Michael Zezas, Samantha Favis and Barbara Boakye said in a note this week that they now had a “constructive outlook” based on improved valuations. They said investors could be “uncomfortable” adding exposure to municipals in the near term, but the securities could end up outperforming other fixed-income alternatives over a six to 12 month period.

So-called crossover buyers, who don’t typically focus on tax-exempt purchases, are already buying bonds at relatively low prices, said Mark Whitaker, senior vice president at Mesirow Financial. But he said that uncertainty around the Federal Reserve, the Treasury market and the geopolitical landscape could continue to weigh on the market.

"Fund flows could still be volatile," he said.

**Bloomberg Markets**

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