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Muni Bonds Are Down So Much That They're Buys Again.

A funny thing happened in the past week, as news emerged of inflation hitting a four-decade high. A few strategists started looking a bit more positively on bonds, or at least somewhat less negatively.

March consumer prices were 8.5% above their level a year earlier, while producer prices were up 11.2%. As bad as those numbers were, they essentially confirmed what we knew already and suggested that the pace of price rises might be close to a peak.

But while the major stock averages were down for the second straight week (and the third for the Dow industrials), the price slide in the bond market slowed. The yield on the benchmark 10-year Treasury (which moves inversely to its price) rose by 0.095 of a percentage point, to 2.808%, bringing the two-week increase to 0.434 of a point and the year-to-date rise to 1.312 points.

The sharp run-up in bond yields has changed the calculus between equities and fixed income.

Truist Advisory Services this past week downgraded its recommended stock exposure to neutral, its lowest level since 2010, owing to the drop in the equity risk premium (the extra return from stocks over bonds). The move reflected a downshift in global economic growth, stickier inflation trends, and ongoing geopolitical risks, as well as Federal Reserve policy tightening, which may mean that growth could suffer if inflation isn't tamed, a research note said.

While such tactical shifts are important to institutional portfolios looking to dampen near-term risks, the absolute yields on government bonds remain relatively unenticing, even though the real yield on the 10-year Treasury inflation-protected security was approaching zero after having been below negative 1% in early March.

Much more attractive are long-maturity investment-grade municipal bonds, with tax-exempt yields hitting 4%, the highest since late 2016, according to John R. Mousseau, CEO and director of fixed income at Cumberland Advisors.

The muni market is going through one of its typical bouts of feast and now famine, he writes in a client note. Tax-free bond funds saw $4.8 billion exit in the week ended on April 6, the most since the financial market meltdown in March 2020, according to Investment Company Institute data reported by the Bond Buyer. Muni fund managers sell what they can to meet redemptions, overwhelming Wall Street dealers with supply, he adds.

The result is a buyer's market, with those 4% tax-exempt yields equivalent to 6.35% on a taxable security, he writes. Indeed, 20-year double-A munis yield roughly the same as their fully taxable corporate counterparts in the low-4% range.

What Cumberland is trying to buy are bonds issued last year at 2% to 3%, which have suffered a "breathtaking backoff in prices," Mousseau adds in an email.

Bonds originally offered around par now may be selling around 70 to 75 cents on the dollar with a yield to maturity of 4.15% to 4.25% for 30-year paper. That price plunge isn't related to credit problems, just higher yields, he emphasizes. To be sure, there are tax complications with discount munis, but they still yield 0.15% to 0.20% more than new-issue par bonds, even after taxes.

If you’re looking to add bond ballast to a balanced taxable portfolio, munis might be your best bet.

Barron’s

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