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High-Yield Municipal Bonds on Track for Worst Year Since 2008.

- **Losses outpace investment-grade munis, company high-yield**
- **Muni high-yield on track to post worst year since 2008**

High-yield municipal bonds are one of the worst-performing sectors of U.S. debt this year, reversing a strong showing in 2021 and encapsulating the lack of demand for state and local government bonds.

Sub-investment grade muni debt is down 9.3% so far this year — outpacing losses in both investment grade munis and high-yield corporate debt — putting it on track for its worst year since 2008, according to Bloomberg data. It's a stark reversal from 2021, when high-yield munis returned nearly 8% and helped make the case that municipal bonds can act as a haven in the fixed-income sector.

But whereas municipal debt was scarce and historically expensive last year, those conditions are no longer present, prompting muni fund outflows over the past 10 weeks. Investors pulled roughly $3.5 billion from municipal-bond mutual funds in the week ended April 20, marking another multibillion dollar week of outflows, according to Refinitiv Lipper US Fund Flows data.

That's had an outsized impact on high-yield muni returns, which tend to appeal to more opportunistic investors and face competition from other asset classes, said Matt Fabian, a partner at research firm Municipal Market Analytics.

"High yield has been unduly dependent on excessive demand versus supply and has been unduly affected by the reversal of demand from mutual funds," Fabian said. "In the prior world, where bonds were scarce, it was doing really well."

There's a sense that the pain isn't over in the sector either.

RJ Gallo, senior fixed income portfolio manager at Federated Investment Management Co., said high-yield municipals can still fall further and that is why he's favoring "mid- to higher-quality" bonds when his team is looking to buy.

"We think it's just a matter of time before more selling starts to come as people react to the losses they've already accrued and that weakness will propagate down the credit spectrum," he said in an interview.

Even a reversal in mutual fund flows and sentiment is unlikely to have an immediate impact on high-yield performance, Fabian said. The competition they face from other sectors means investors are quick to look for other options.

"It's less about warehousing tax-exempt income and more about outperforming other high-yield alternatives," he said. "If the global markets are still weak, then high yield will be encumbered by that."

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By Fola Akinnibi

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— *With assistance by Danielle Moran*