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BlackRock Says It Prefers Short-Term Muni Bonds Amid High Rates.

- **One-year munis down 1.6% this year, while benchmark fell 9.7%**
- **‘More defensive stance is warranted’ due to seasonal trends**

BlackRock Inc. says it now prefers short-term municipal bonds as a way to protect against rising interest rates and a hawkish Federal Reserve.

Short-dated notes have been among the best-performing segments of the $4 trillion municipal debt market in 2022, as rising interest rates left longer-dated securities deep in the red. An index of one-year munis has lost about 1.6% since January, outperforming the market’s benchmark and long-term debt, which has lost 9.7% and 16.7%, respectively, data compiled by Bloomberg show.

“We have shifted to a short-duration stance on municipal positioning and have increased cash balances,” a note by Peter Hayes, James Schwartz and Sean Carney emailed on Wednesday said. “We favor the intermediate part of the yield curve to maximize income, while avoiding significant duration risk, and are targeting bonds with defensive structures.”

Autumn in the US is traditionally a tough period for munis partly because it’s when sales of new bonds tend to pick up after a summer lull. And rising interest rates will likely put more pressure on the asset class.

“A more defensive stance is warranted as seasonal trends typically turn less favorable,” the note said.

The municipal bond market typically sees increased demand from an uptick in principal and interest payments in the middle of the year, which investors channel back into the market. But come September, those payments tend to decline. CreditSights Inc. estimated that principal and interest payments will total about $31 billion in September, down from about $55 billion the prior month.

Overall, the muni market is on track for its worst year in decades with US state and city debt posting an average return of -0.53% in September — the worst performance of any month over the past six years, according to Bloomberg data.

As such, the asset manager prefers higher-quality bonds overall, with a neutral allocation to non-investment grade bonds.

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