Bond Case Briefs

Municipal Finance Law Since 1971

Are Munis The Antidote To Recessionary Fears?

As lending tightened following the collapse of Silicon Valley Bank and job growth slows, the Fed may finally be seeing the cooling of the economy it set out to orchestrate, according to fixed-income managers at Los Angeles-based Capital Group.

For investors, it's time to reexamine the shifted landscape, they said, and one of the best places to look for some stability is municipal bonds.

Karl Zeile, a portfolio director, and Greg Ortman, an investment director, wrote in a joint publication "Recession Resilience: Municipal Bonds Can Help Shield Portfolios" that while many high-quality bond sectors can do well in a recession relative to equities, municipal bonds have some unique advantages that could make them bright spots in an otherwise dismal investment environment.

Those advantages include distinctive characteristics that provide some resistance to recessionary impact, high current yields and strong post-pandemic fundamentals, all of which act as a buffer if growth continues to slow and recession fears mount.

Zeile wrote that should the U.S. enter a recession, he expected it to have all the hallmarks of a traditional recession. "I would expect equities to experience a correction due to the pressure on earnings," he said. "The job market may weaken, causing a cash crunch for consumers, and economic growth would further contract."

While that sounds unpleasant, those are pains that lead to municipal bond gains. The services supported by municipal revenue bonds tend to be essentials, like water and sewer services, garbage collection and tax collection. Consumers may skip a lot of things, but the essentials are the last to go, providing that recession resistance.

"When recession knocks at the door with a car payment, credit card and a water bill due, everyone wants the ability to take a shower," Ortman said. "People might not dine out at a restaurant, but they will open their wallets for water, electricity and gas to avoid shutoff."

In addition, municipal bond yields are still at or near decade highs, with the yield to worst for the Bloomberg Municipal Bond Index hovering around 3.25% at the end of March, they said, and the likelihood of negative returns even in the wake of market shocks is less than it was a year ago. And, as always, the income on the investment is federally tax-free, and sometimes tax-free at the state level as well.

Add to that the fundamental strength of the municipalities issuing these bonds, and this corner of the fixed income market is unusually flush. The federal government disbursed billions of dollars to tribal, local and state government through the pandemic, and those strong balance sheets buoy the general obligation side of the muni bond market.

Still, not every sector deserves a buy, Zeile and Ortman said. For example, transportation agencies are still reeling from the pandemic and a recession, wherein movement and ridership slows, could spell trouble. Similarly, healthcare and hospitals are still struggling with costs and staffing shortages.

“Even with those considerations, selectivity is possible,” Zeile said. “To skirt some risk and consider credit quality, investigate a multi-state system or an integrated provider versus a single-site, standalone hospital.”

FINANCIAL ADVISOR

by JENNIFER LEA REED

APRIL 7, 2023