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Municipals Set Up for a Summer Rebound.

May update

- Munis posted negative total returns but outperformed comparable Treasuries in May.
- Bank portfolio liquidations have been less disruptive than initially feared.
- Better valuations and improving supply and demand dynamics should spur summer strength.

Market overview Municipal bonds posted negative total returns in May amid continuing heightened volatility. Interest rates rose throughout most of the month as banking concerns abated, economic data exceeded expectations, comments from the Federal Reserve turned more hawkish, and debt ceiling negotiations remained contentious to the very end. The Bloomberg Municipal Bond Index returned -0.75%, bringing the year-to-date total return to 1.62%. The asset class underperformed comparable Treasuries in the intermediate part of the curve but outperformed in both the front end and long end. Shorter-duration (i.e., less sensitive to interest rate changes) and triple-B-rated bonds performed best.

Fund flows remained consistently negative but were counterbalanced by manageable primary and secondary supply. The issuance was in line with historical expectations at $31 billion, 2% below the five-year average, and outpaced reinvestment income from maturities, calls, and coupons by $3 billion. As a result, deals were oversubscribed by 4.3 times on average, slightly above the year-t--date average of 4.0 times. At the same time, anticipated bank portfolio liquidations were less disruptive than initially feared. Selling was orderly and resulted in only a negligible month-ove--month increase in daily bid-wanted. Lower-coupon bonds with shorter maturities made up the bulk of activity.

Continue reading.

by Peter Hayes, James Schwartz, Sean Carney of BlackRock, 6/15/23