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High-Yield Municipal Bonds: A Cautious Outlook for 2024

High-yield municipal bonds, a star performer in the financial arena with a 9.2% gain in 2023, are expected to tread on a different trajectory in 2024. Money managers, who had reaped the benefits of a limited supply of high-yield offerings and a broad market rally initiated in November of the previous year, caution against expecting a repeat performance.

Potential Challenges in 2024

The financial forecast for 2024 is mired with potential hurdles, including the possibility of the Federal Reserve cutting interest rates and an increase in municipal issuers making a beeline to borrow. The slowing U.S. economy could especially impact sectors such as nursing homes, tobacco bonds, and charter schools, that form a significant chunk of the high-yield muni market.

A Growing Concern for Defaults

A survey by Hilltop Securities has raised red flags about potential defaults, particularly in senior living facilities. The survey found 45% of the respondents, who were high-yield muni investors, expressing their concern. Financial institutions, BNY Mellon Wealth Management and Barclays, echo this sentiment of caution with their prediction of a subdued performance for high-yield munis. Barclays, in particular, forecasts mid-to-low single-digit returns.

Presidential Elections and Market Performance

The upcoming U.S. presidential election is poised as a potential game-changer for high-yield muni performance. Changes in economic policies, a likely outcome of the election, could send ripples across the financial sector, influencing the performance of these bonds.

Optimism Amid Uncertainty

Despite the cautious outlook, there are optimists like Franklin Templeton Fixed Income's municipal-bond team who believe in the potential for improved performance. The team opines that with interest rates on the decline and capital availability, the stage could be set for better performance if mutual fund inflows occur. However, recent data from LSEG Lipper paints a different picture, showing outflows from high-yield muni funds and indicating investor hesitation. Market participants are advising prudence in the face of economic uncertainties and potential Federal Reserve rate cuts in 2024.

By: BNN Correspondents

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