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Record Issuance, Strong Yields Put Municipal Bonds in Play.

Record issuance in municipal bonds is injecting the debt market with a healthy dose of supply. Combined with elevated yields, this puts municipal bonds in play for any bond portfolio to benefit.

Record issuance is happening at both the private and public sectors. This is because expectations of rate cuts by the Federal Reserve will allow issuers to take on more debt now and refinance later at lower rates. In addition to attractive yields, municipal bonds offer investors higher credit quality that can appease risk-averse investors who want yield, but not the additional credit risk other debt could carry. With the tailwinds of strong fundamentals behind it, municipal bonds are an ideal option to balance yield and credit risk.

“We expect that the fundamental backdrop will remain strong,” private investment management company Lord Abbett said. “While the record-setting growth in tax revenues and rainy-day balances has moderated over the last year, we believe that municipal credit is returning to a more normalized environment.”

“Tax receipts are still significantly above levels experienced prior to the pandemic, and rainy-day balances relative to spending remain multiple times higher than during much of the last 15 years,” the firm added. “With the decline in growth of tax receipts, we also anticipate spending by state and local governments will lessen, as many states move beyond the one-off expenditures of last year.”

Tax-Free Income in One Fund

A prime benefit of munis is the tax-free income they can offer that’s beneficial for investors in higher income tax brackets. Rather than opt for a variety of muni bond holdings, an easier way is via one ETF: the well-diversified Vanguard Tax-Exempt Bond ETF (VTEB).

The fund tracks the Standard & Poor’s National AMT-Free Municipal Bond Index, which measures the performance of the investment-grade segment of the U.S. municipal bond market. Overall, this index includes municipal bonds from issuers, primarily state or local governments or agencies whose interests are exempt from U.S. federal income taxes, and the federal alternative minimum tax.

Of course, a top-of-mind goal for fixed income investors, especially in a year in which rate cuts could happen at a quick pace, is extracting the most yield in the current macroeconomic environment. To that note, VTEB brings a yield of 3.33% (as of February 23), with an average duration of 5.6 years and average stated maturity of 13.6 years.

ETF TRENDS

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MARCH 1, 2024

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