
Tax Season Could be Boon for Muni Bonds.

Financial advisors looking to move cash off the sidelines this spring see opportunities in the municipal bond market.

Wealth managers move a lot of money around during tax season to meet client obligations. Several advisors say that this year, a lot of leftover cash from all that shuffling could end up in municipal bonds, especially for those high-net-worth clients living in high-tax states.

Over $1.2 trillion went into money-market funds in 2023, according to Bank of America, and with the Federal Reserve expected to cut rates at some point this year, financial advisors will be looking to take some of that cash off the sidelines and put it to work after Uncle Sam gets his due.

For those in the top tax bracket, investment-grade municipal bonds can achieve a taxable equivalent yield of up to 8 percent, which compares to the approximately 5 percent that money-market funds are currently paying.

Sam Weitzman, product specialist at Western Asset Management, says tax season tends to be a good time to leg into municipal bonds because investors are often selling out of their municipal bond positions to pay their taxes. As a result, new buyers are rewarded with marginally higher yield opportunities.

“We also saw taxes go down in 2018 following the Tax Cuts and Jobs Act,” Weitzman said. “Those tax cuts are slated to expire next year, and with that, we’re expecting a higher tax rate environment to further improve the value of tax-exempt income.”

As to what types of munis offer the best value in the current market, Weitzman said the highest quality portion of the market inside of 10 years appears overly crowded. Instead, he prefers doing a little more work for his clients to unearth opportunities “down the credit spectrum.”

“Right now, single-A munis and triple-B munis are offering about 100 basis points of after-tax yield pickup if you’re in the top tax bracket,” he said. “And to us, that’s a really attractive relative value proposition given the fact that munis tend to default much less frequently than those corporate counterparts.”

Speaking of defaults, Steve Stanganelli, certified financial planner at Clear View Wealth Advisors, worries that the ability of municipalities to tax their constituents is starting to push up against the ability of taxpayers to tap their wallets for debt service. Anecdotally speaking, he sees such fiscal challenges building in his own city and is concerned that similar scenarios are playing out across the country.

Nevertheless, he uses several Nuveen closed-end funds for clients, including the Nuveen AMT-Free Quality Muni (NEA), the Nuveen Quality Muni-Income (NAD), and the Nuveen Municipal Credit Income (NZF), because they offer high-yield dividends that are tax-advantaged.

“Despite my longer-term concerns about municipal tax revenues, in the near term munis are well positioned as investors are often buying them for safety. And for my higher-income clients, these tax advantages help boost yields even more,” Stanganelli said.

Jonathan Swanburg, president of TSA Wealth Management, agrees that for clients with taxable accounts that are in the highest tax brackets, municipal bonds are a sensible purchase at any time of year, not just during tax season.

“In Texas where we have no state income tax, a taxpayer making more than $731K is going be at a 40.8 percent effective tax rate on additional bond income. For this client, a 4 percent muni bond would have the same effective yield as a 6.76 percent corporate or Treasury,” Swanburg wrote in an email. “If that same client was at the highest income levels and lived in New York City, her effective tax rate would be around 55 percent in total. In her case, buying a NY City municipal bond would have a tax equivalent yield of 8.8 percent relative to a corporate and 6.76 percent relative to a Treasury.”

The biggest issue Swanburg sees with municipal bonds in the current environment is that investors will often buy them thinking tax-free income is universally better than taxable income. However, that’s not necessarily the case for investors outside the highest tax brackets.

“It is very common for retirees, even high-net-worth retirees, to be in lower tax brackets. At the 24 percent marginal bracket, for example, a 4 percent muni has the equivalent yield of a 5.26 percent corporate. If the equivalent-risk corporate is yielding more than that, the investor is better off going with the taxable bond,” he said.

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