Don’t fight the Fed, buy dips

BlackRock.

Municipal September update

- Municipal bonds posted their fourth consecutive month of positive performance.
- Issuance remained elevated but was well absorbed amid firm demand.
- We expect volatility ahead of the election but see many reasons to be optimistic into year end.



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Market overview

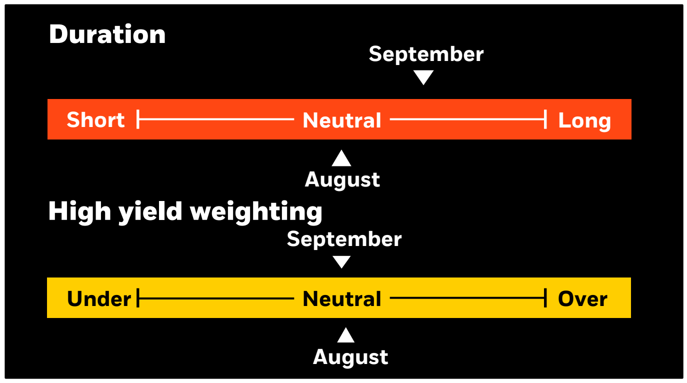
Municipal bonds bucked the seasonal trend and posted strong performance in September. Rallying interest rates provided leadership as the Federal Reserve started its long-awaited easing cycle by lowering the federal funds rate by 50 basis points to 4.75%-5.00% and indicated additional rate cuts in the months ahead. The S&P Municipal Bond Index returned 1.01%, bringing the year-to-date total return to 2.89%. Longer-duration bonds and higher-rated credits performed best.

Supply once again surpassed expectations as deals were pulled forward ahead of the election. Issuance totalled $46 billion, 19% above the five-year average, bringing the year-to-date total to $369 billion, up 40%, year over year. Meanwhile, demand picked up as investors shifted cash further out the curve, resulting in mutual funds receiving $4.6 billion in inflows. Consequently, deals were well absorbed, oversubscribed 5.1 times on average, above the year-to-date average of 4.3 times.

While we expect heightened volatility between now and Election Day, the market could be poised for a strong finish to the year. November and December have posted positive performance in each of the past five years, cumulatively accounting for 135% of full-year total return on average. In addition, performance has historically been strong following the start of rate cutting cycles. For now, we will continue to strategically deploy cash by leveraging the large primary calendar and capitalizing on any concessions in the new issue market. As election-related uncertainties diminish, we expect to adopt a more aggressive stance toward the end of the year.

Strategy insights

We remain neutral duration overall but will look to add on weakness. We advocate a barbell yield curve strategy, pairing front-end exposure with the 15-20-year part of the curve. We prefer single-A rated credits but think high yield offers a good risk-reward opportunity, given attractive carry, favorable structures, and the ability to generate alpha through security selection.



Overweight

- Essential-service revenue bonds
- Suburban governments and school districts
- Flagship universities
- Select issuers in the high yield space
- National and large regional health systems

Underweight

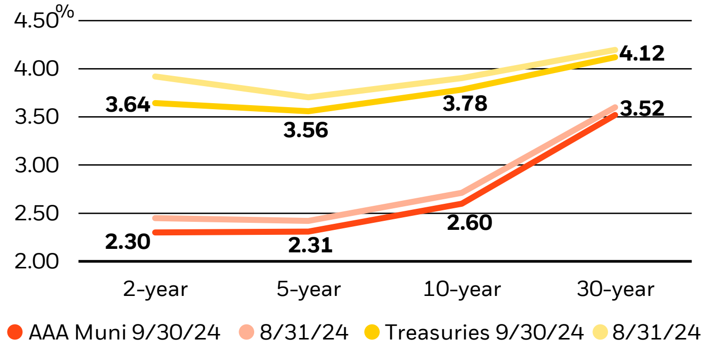
- Speculative projects with weak sponsorship, unproven technology, or unsound feasibility studies
- Senior living and long-term care facilities
- Small private colleges
- Stand-alone and rural health providers

Credit headlines

Hurricane Helene, the third hurricane to strike Florida's Big Bend region within just over a year, caused unprecedented flooding across 600 miles and resulted in more than 130 fatalities. Predicted to be one of the most costly in U.S. history, initial damage estimates range from $145 billion to $160 billion, trailing only Hurricane Harvey's $190 billion in 2017. Areas typically unaffected by severe weather, such as inland and mountainous regions in the Carolinas and Tennessee, have also reported damage. The most affected insurers are Florida-only carriers like Citizens, the state's insurer of last resort. However, Citizens is financially prepared for Helene's aftermath with $15 billion available for claims. The Biden administration has declared Major Disaster zones in Florida, North Carolina, South Carolina, and Georgia, unlocking federal funds for affected counties. Emergency Declarations, which release fewer funds compared to Major Declarations, have been issued in Tennessee and Virginia. Historically, long-term credit deterioration for debt-issuing public entities in affected areas has been minimal owing to federal and state aid, private insurance, and charitable donations. However, long-term impacts could include population migration and insurers' hesitation to operate in these areas, potentially leading to decreased property values and tax revenues.

The International Longshoremen's Association agreed to suspend a strike that had briefly closed ports on the East and Gulf Coasts after receiving an improved wage offer from port employers. The strike had the potential to cause substantial economic losses, estimated at $4 billion to $5 billion per day. The union reached a tentative agreement on wages and its 45,000 members will return to work, with the current contract extended until January 15, 2025. The wage increase will raise the top longshoremen's wage to just over $63 per hour at the end of a new six-year contract. The issue of automation at the ports and improved retirement benefits are still to be negotiated. Credit concerns for these seaports remain limited.

Municipal and Treasury yield movements



Sources: BlackRock, Bloomberg.

Municipal performance

	Sept'24	YTD
S&P Municipal Bond Index	**1.01%**	**2.89%**
Long maturities (20+ yrs.)	1.50%	4.19%
Intermediate maturities (3-15 yrs.)	0.90%	2.18%
Short maturities (6 mos.-4 yrs.)	0.43%	2.66%
High yield	1.40%	7.79%
High yield (ex-Puerto Rico)	1.45%	8.24%
General obligation (GO) bonds	0.99%	2.27%
California	1.04%	2.74%
New Jersey	1.02%	2.72%
New York	0.96%	2.52%
Pennsylvania	1.08%	3.23%
Puerto Rico	1.03%	4.84%

Sources: S&P Indexes.

Investment involves risk. *The two main risks related to fixed income investing are interest rate risk and credit risk. Typically, when interest rates rise, there is a corresponding decline in the market value of bonds. Credit risk refers to the possibility that the issuer of the bond will not be able to make principal and interest payments. There may be less information available on the financial condition of issuers of municipal securities than for public corporations. The market for municipal bonds may be less liquid than for taxable bonds. A portion of the income from tax-exempt bonds may be taxable. Some investors may be subject to Alternative Minimum Tax (AMT). Capital gains distributions, if any, are taxable.* ***Index performance is shown for illustrative purposes only. You cannot invest directly in an index. Past performance is no guarantee of future results.***

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