Municipals post strong gains in November

BlackRock.

December update

- Revised infrastructure bill and declining interest rates drove strong performance.
- Higher market supply was easily absorbed by robust demand.
- We expect the market to benefit from favorable seasonal trends in December and January.



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Market overview

Municipal bonds (munis) performed well in November. The market benefited from clarity on pending infrastructure legislation, as well as falling interest rates amid uncertainty following the discovery of the coronavirus Omicron variant. The S&P Municipal Bond Index returned 0.74% for the month, bringing the year-to-date (YTD) total return to 1.62%. Munis outperformed comparable U.S. government bonds for the period as investors saw the return of favorable supply/demand conditions after a new draft of the Build Back Better infrastructure bill excluded anticipated municipal-specific provisions that would have increased supply. High yield munis, led by issuers in Puerto Rico and the tobacco sector, and longer-duration bonds, were the month's best performers.

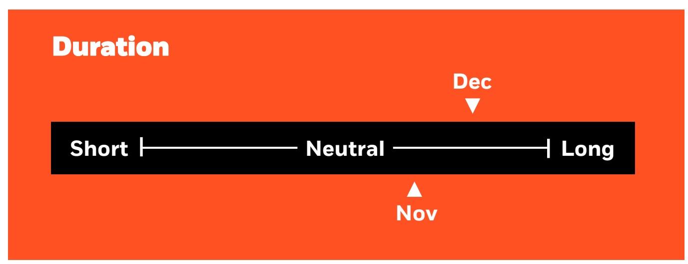
Supply exceeded expectations, avoiding the large month-over-month slowdown typically seen in November, but was ultimately met with firm demand. Issuance totaled $38 billion—13% above the five-year average—bringing the YTD total to $417 billion. Deals were oversubscribed 5.8 times on average, the largest imbalance of buyers to sellers since May, as investors began positioning ahead of seasonally favorable year-end market conditions.

Demand rebounded from October's slowdown. The market posted $4.7 billion in net inflows, concentrated in long-term and high yield funds. We saw limited selling for tax-loss purposes, but this trend usually peaks in December.

While acknowledging rich valuations, we expect the market to benefit from a seasonal return to net negative supply in December and January, where reinvestment income (from maturities, calls, and coupons) outpaces new supply and typically drives strong performance.

Strategy insights

We have shifted to a long-duration stance on municipal bond positioning and maintain a barbell yield curve strategy. We prefer lower-rated investment grade bonds, particularly in the front end of the yield curve, as well as select high yield credits. We maintain a favorable view on the tax-backed, transportation, healthcare, and education sectors.



Yield curve

Barbell strategy, preferring 0-5 and 20+ years.

Overweight

- Higher quality states and essential-service bonds.
- School districts and local governments supported by property taxes.
- Issuers that should benefit from the re-opening of the economy.
- Select issuers in the high yield space.

Underweight

- Speculative projects with weak sponsorship, unproven technology, or unsound feasibility studies.
- Senior living and long-term care facilities in saturated markets.

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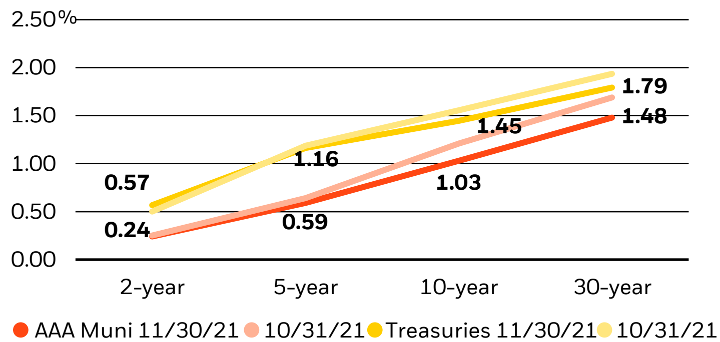
Credit headlines

The emergence of Omicron has raised concerns that may affect municipal airports. Before this new variant, domestic air travel had improved in November to approximately 87% of pre-Covid levels, recovering from recent weakness caused by the end of peak-summer travel and the previous coronavirus variant of concern, Delta. Leisure bookings continue to outperform business travel, with corporate sales down 39% from 2019. Domestic airports have benefited from three rounds of stimulus funding, with relief legislation—totaling approximately $20 billion—enabling management teams to cover interim expenses and stabilize rates for airline and concession businesses. Additionally, the passage of the Infrastructure Investment and Jobs Act earlier in November should give the segment some certainty and additional cushion moving forward. We anticipate an increase in restrictions for international travel and a potential short-term dip in bookings, but vaccines, natural immunity, and a return of safety protocols could soften the financial impact. Market reaction has so far been muted, but any related market weakness could present a buying opportunity.

Container volumes at North America's largest ports have surpassed pre-pandemic levels, but disruptions in the global supply chain have created significant congestion problems limiting the movement of goods between vessels and facilities. Of particular concern is congestion at the California ports of Long Beach and Los Angeles, which handle 40% of U.S. container volume and are heavily impacted by trade with Asia. While many steps have been taken to ease the congestion, several issues remain and are unlikely to be resolved in the short term. However, longer-term capital plans are in place to bolster U.S. seaport capacity, including bond-related financings in South Carolina, Georgia, and most recently the Port of Houston, in Texas.

Municipal and Treasury yield movements



Sources: BlackRock: Bloomberg.

Municipal performance

	Nov 2021	YTD
S&P Municipal Bond Index	**0.74%**	**1.62%**
Long maturities (20+ yrs.)	1.37%	3.64%
Intermediate maturities (3-15 yrs.)	0.59%	0.97%
Short maturities (6 mos.-4 yrs.)	0.04%	0.39%
High yield	1.29%	6.48%
High yield (ex-Puerto Rico)	1.26%	6.51%
General obligation (GO) bonds	0.70%	0.91%
California	0.72%	1.20%
New Jersey	0.73%	2.44%
New York	0.82%	1.94%
Pennsylvania	0.74%	1.95%
Puerto Rico	1.37%	5.65%

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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