

MUNIWATCH

FIXED INCOME MARKET UPDATE



Despite elevated Tax-Exempt Muni issuance, Munis continue to rally and outperform their U.S. Treasury and Corporate bond counterparts.

The Muni Market continues to experience record-setting fund inflows that are fueling unrelenting demand, outstripping this elevated supply.

Anticipating higher future income tax rates, investors continue to flock to Munis, even though other fixed income investments offer a better value proposition.

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Muni Issuance Surges, Yet Prices Remain High

At over \$133 billion, year-to-date issuance is \$17 billion higher than the average at this point in the past three years (graph, top-right). While elevated Muni issuance would typically lead to higher yields and lower prices, Munis have maintained historically high prices and low yields. The 10-year Muni-to-Treasury yield ratio fell to 61% as of May 31, compared to an average of 93% over the past three years and near the all-time lows reached in February (graph, middle-right).

Fund Inflows Fuel Demand, Overwhelm Surging Issuance

Through May, Muni Mutual Funds have raked in nearly \$50 billion, significantly more than any recent year (graph, bottom-right). Even as supply has surged and prices of other fixed income assets have declined, these continuous massive inflows have led to a supply/demand imbalance and a virtual floor for Muni prices.

Increasing Future Tax Rates Draw Investors to Munis

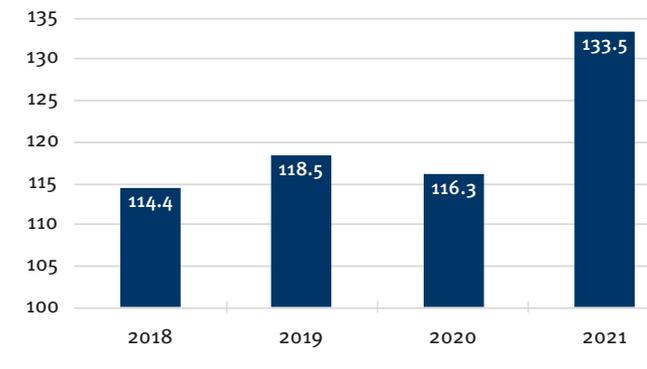
We attribute this flood of demand in part to investors' anticipation of higher future income tax rates. However, even if the current Treasury proposal is enacted and the top income tax rate is increased from 37% to 39.6%, the taxable-equivalent yield is still higher on an ultra-high-grade Corporate bond.

Top Federal Income Tax Rate	37%	39.6%
10yr AAA Muni	1.57%	1.63%
10yr U.S. Treasury	1.60%	1.60%
10yr AAA Corporate	1.80%	1.80%

While higher tax rates can be expected, the flood of demand for Munis seems unwarranted and unsustainable as other fixed income investments offer a better value proposition at current levels.

TAX-EXEMPT MUNI ISSUANCE THROUGH MAY (IN BILLIONS)

Source: Bloomberg. Data as of May 31, 2021.



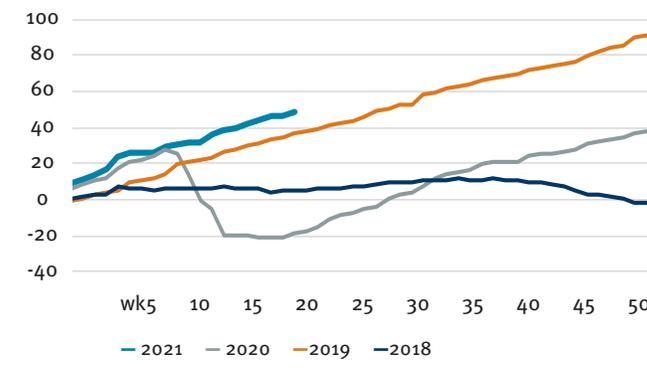
MUNI-TO-TREASURY RATIO

Source: Bloomberg, Refinitiv TM3. Data as of May 31, 2021.



CUMULATIVE MUNI MUTUAL FUND FLOWS (IN BILLIONS)

Source: Refinitiv Lipper. Data as of May 31, 2021.



STATE OF THE STATES



States have rebounded from bleak forecasts a year ago to pass record budgets. According to a recent report by The Pew Charitable Trusts, tax revenue had offset pandemic-related losses in 29 states through February, even before nearly \$200 billion in federal aid to states had been paid. This has led to budget spending plans that are up 10% or more in many states. These stronger-than-expected revenues and continued federal aid, combined with the aforementioned supply/demand imbalance, is reflected in the dramatic spread narrowing over the past year (far right column).

* Proxy Issuer used.

States with insufficient GO debt or lack of Proxy Issuer: MO, AL, IA, NM, WV, AK, ME, ND, ID, SD, MT, VT, WY

STATE GO 10YR YIELD AND SPREAD TO AAA

Spread widening noted as (+), spread narrowing noted as (-)

Source: Bloomberg. Data as of May 31, 2021.

State	Yield on 10-Yr Maturity (%)	Current Spread to 10-Yr AAA Muni (bps)	3-Mo Change in Spread (bps)	1-Yr Change in Spread (bps)
CA	1.05	10	-7	-14
NY	0.96	0	-18	-43
NYC MTA	1.44	48	-31	-257
TX	1.08	12	+10	-9
IL	1.74	78	-64	-318
FL	1.06	10	+1	+2
PA	1.14	19	-5	-39
NJ	1.30	35	-39	-42
OH	0.98	2	-7	-17
MA	1.05	10	-4	-2
WA	1.06	10	-7	0
MI	1.04	9	-2	-15
CO*	1.06	11	+1	-4
VA	0.99	4	-4	+2
GA	1.04	8	+3	+8
MD	1.02	6	-2	+3
WI	1.07	11	+2	+1
MN	0.99	3	-1	-2
AZ*	1.10	14	+1	-20
CT	1.25	29	-4	-74
NC	1.05	9	+1	+7
OR	1.06	11	+2	+3
IN*	1.11	15	+7	+1
TN	1.12	16	+8	-1
SC	1.05	9	-1	-2
LA	1.16	20	-7	-26
KY*	1.24	28	-11	+4
DC	1.00	5	-10	-13
NV	1.10	15	-3	-35
UT	1.03	8	+2	+8
KS*	1.16	20	-4	-45
NE*	1.30	34	-4	-5
OK*	1.06	10	-16	-8
HI	1.11	16	-14	-20
MS	1.14	18	+9	-1
AR*	1.16	21	-15	-10
RI	1.11	15	-2	-24
DE	1.04	9	-7	+9
NH	1.03	8	+3	0

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