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Municipal Bond Market Update: November 2023

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Making Hay While the Sun Shines:

How the age old wisdom applies to the current muni environment

Being based in the Midwest, surrounded by farmland and far removed from the noise of New York City and Wall Street, there's a common saying that resonates with our current approach to the municipal bond market: "make hay while the sun shines."

You might be wondering how that phrase has anything to do with municipal bonds. To draw a parallel, we find ourselves metaphorically "out in the field." We're capitalizing on the attractive yields currently available in the market. Predicting the precise direction of interest rates is near impossible. Just two years ago, many would have argued rates would go higher. They would have been correct. Though, few could have foreseen rates soaring to 20-year highs.

However, our perspective suggests that we are now in the latter stages of the rate tightening cycle. Historical trends advise that it's usually better to act early than to lag behind when interest rates reverse course and the Federal Reserve begins to lower them. The Federal Reserve's current "dot plot" projections shows a median target rate of 3.875% exiting 2025 or 150 basis points lower than the current target rate of 5.25-5.50%.

It's also a rarity for municipal bonds to post negative returns, and the occurrence of two consecutive years with negative performance is practically unheard of. In each of the last five municipal rate spikes, bond prices were generally higher 12 months after the rise in rates. As of this writing, municipal bonds appear on track to register back-to-back years of negative performance. We believe this could be a generational opportunity in municipal bonds. Investment grade municipal portfolios offer attractive taxable equivalent yields and diversification. So, to return to the original sentiment of this piece, we are heeding the age-old wisdom to "Make hay while the sun shines."

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