Munis take another look

Even in an uncertain environment, municipal bonds show promise as a tax-efficient, stable asset class.

Changes under the Tax Cuts and Jobs Act of 2017, particularly the $10,000 cap for state and local tax (SALT) deductions, helped spark additional interest in municipal bonds. In fact, through the end of May the municipal bond market had seen 21 straight weeks of inflows, while supply over that same period was lower than both the previous year and longer term averages.[1]

We anticipate demand will continue to outpace supply as we head into the summer months, where issuance in the municipal market has typically trended lower. Since 2012 between June and August, net supply has averaged negative $30 billion, as maturities have outpaced new issuance over those months, with 2019 shaping up to follow the familiar seasonal pattern.

Fundamental credit health remains quite strong, and a windfall of record April tax collections has further bolstered most state budgets. Drivers of municipal credit health can be unrelated to strength or weakness in the broader economy — a feature that makes them particularly attractive in later stages of an economic cycle — which typically leads to low or negative correlations with equities. This is relevant because the end of June marked the current economic expansion as the longest in U.S. history. Though we are not forecasting an imminent recession, recent data indicates that growth has clearly moderated from its post-tax-cut highs.

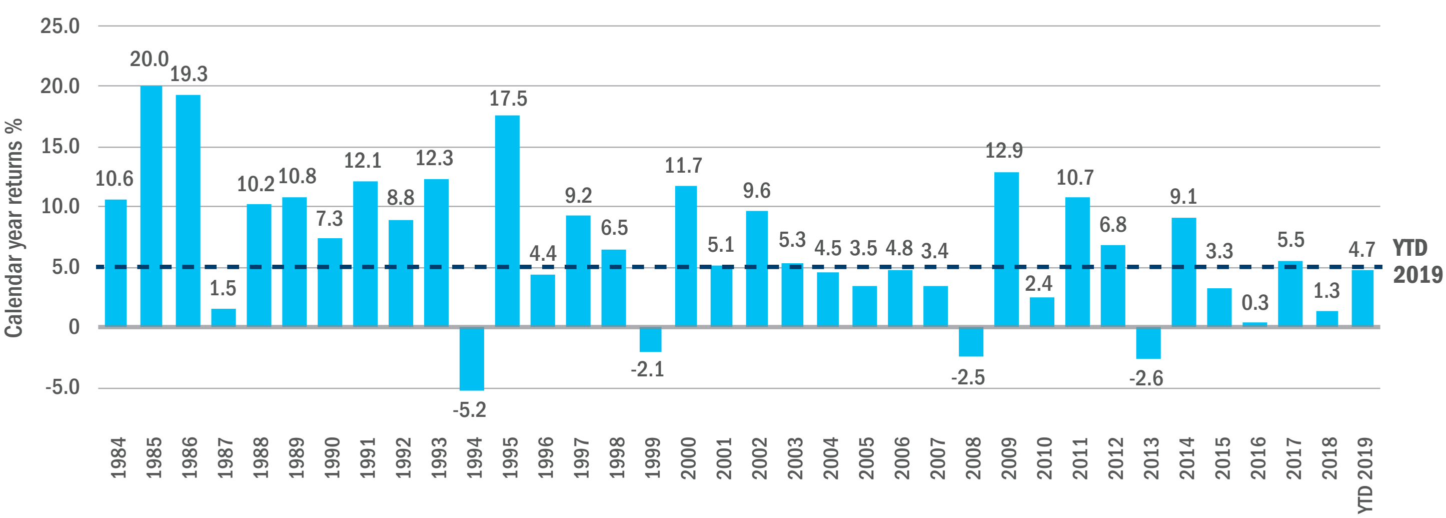
One argument for considering municipal bonds in today's environment is that munis have typically fared relatively well in periods of slowing growth or market uncertainty. In fact, they've generated positive returns in 31 of the last 35 years.[2] In more recent history, the dramatic equity volatility in the fourth quarter of 2018 saw equities, as measured by the S&P 500, fall by 13.5%, while the Bloomberg Barclays Municipal Index returned 1.69%.[3] We anticipate near-term market volatility to remain elevated, making the risk characteristics of munis even more appealing.

Concerns over slowing global growth, Brexit uncertainty, lackluster domestic economic data and the possibility of protracted trade disputes with some of our largest trading partners have softened the tone coming out of the Federal Reserve. This supports our view that rates are likely to remain contained this year. Given the prospect of a more bond-favorable interest rate environment, we believe that municipals are poised to remain an attractive asset class for the remainder of the year, especially after considering the tax benefits. While munis have started the year well, with the Bloomberg Barclays Municipal Index returning 4.71% through the end of May, 22 out of the last 35 years have ended with total returns in excess of that mark.

Bottom line

For investors seeking to keep more of what they earn, the SALT deduction cap has fundamentally shifted the demand for municipals upward. Coupled with issuance expectations that show flat to slightly lower supply for 2019, favorable supply/demand technicals could continue to drive positive municipal performance. Uncertainty is likely to persist in the near term, but munis may offer opportunities to own a tax-efficient, stable asset class with promising prospects ahead. Skilled active management that combines thorough credit analysis and expert navigation of a fragmented marketplace can help uncover those opportunities.

BLOOMBERG BARCLAYS MUNICIPAL INDEX[2]



[1] Source: Lipper, Inc.
[2] Source: Bloomberg Barclays Municipal Index: calendar year returns 1984-2018, YTD 2019 performance as of 05/31/19
[3] Source: S&P 500 Index, Bloomberg Barclays Municipal Index: Total Return performance 09/30/18 – 12/31/18
Past performance is not a guarantee of future results. You cannot invest directly in an index.

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The **Bloomberg Barclays Municipal Bond Index** is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year. The **S&P 500 Index** tracks the performance of 500 widely held, large-capitalization U.S. stocks.

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* In U.S. dollars as of June 30, 2019. Source: Ameriprise Q2 Earnings Release. Contact us for more current data.

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