nuveen
A TIAA Company

October 2024

# Municipal market: Bonds are acting like bonds again

*The first half of 2024 saw continued market volatility as investors assessed the impact of potential U.S. Federal Reserve rate cuts. With the Fed beginning its cutting cycle, investors can focus on municipal bonds behaving like bonds again: offering tax-exempt income and potential capital appreciation while reducing downside risk.*

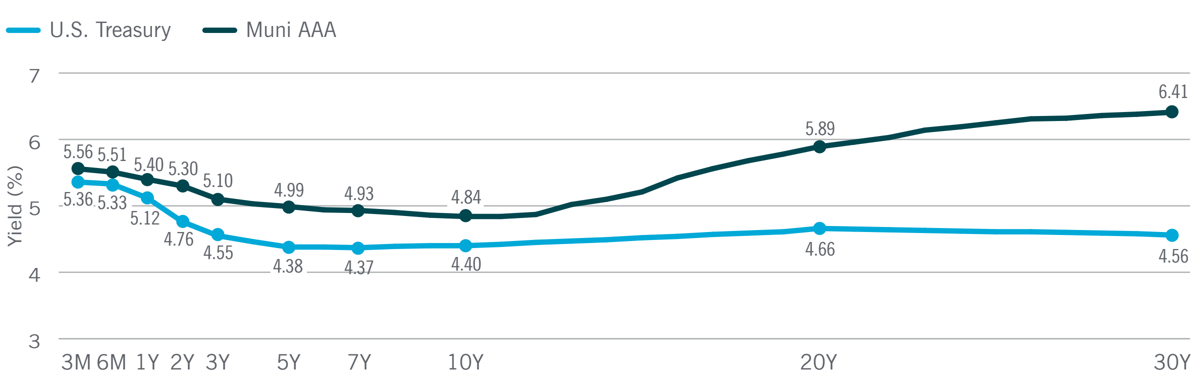
## LONGER DURATION IS COMING INTO FAVOR

The Fed began cutting rates in September, with the median of the dot plot of individual expectations indicating approximately three or four rate cuts into early 2025. Such an environment has historically steepened the yield curve.

A steepening yield curve should be positive for longer-duration bonds, allowing investors to receive higher income associated with longer-duration bonds while earning additional total return through a combination of declining rates and rolling down the curve.

**Figure 1: By extending duration, investors may achieve higher tax-efficient yields**

*U.S. Treasuries versus AAA municipal yield curve (taxable-equivalent yield)*

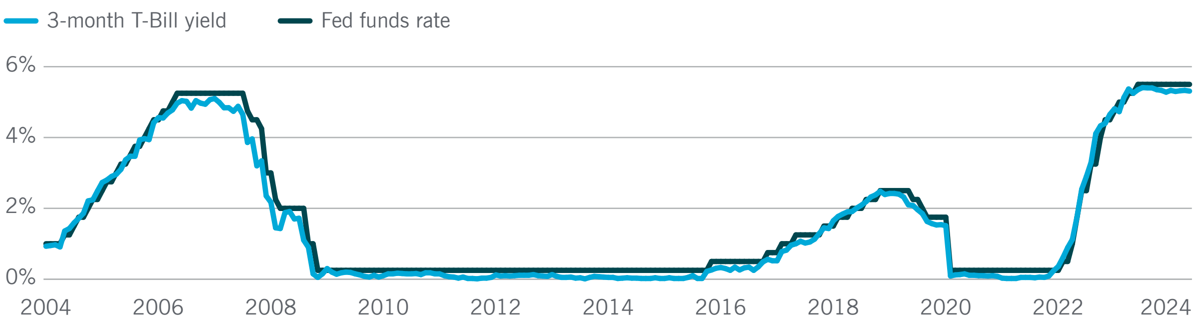



Data source: Bloomberg, L.P., Nuveen Portfolio Strategy & Solutions, 30 Jun 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Taxable-equivalent yield (TEY)** is the yield a taxable investment needs to possess (before taxes) for its yield to be equal to that of a tax-free municipal investment. The yields shown are based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income. Individual tax rates may vary. They do not take into account the effects of the federal alternative minimum tax (AMT) or capital gains taxes.

## SHORT-TERM YIELDS WILL NOT LAST

The conclusion of the hiking cycle likely means short-term yields have already peaked. Bond yields have historically fallen by about one percentage point on average in the year following the last Fed rate hike, and despite increases on yields to date, have begun trending lower.

**Figure 2: Yields have fallen quickly when the Fed stops hiking**




Data source: Bloomberg, L.P., Federal Reserve Projection Materials, 27 Feb 2004 – 30 Jun 2024. **Performance data shown represents past performance and does not predict or guarantee future results.** Fed tightening cycles: 30 Jun 2004 to 29 Jun 2006; 15 Dec 2015 to 19 Dec 2018; current cycle began 16 Mar 2022.

> ***The conclusion of the hiking cycle*** *likely means the end for these attractive short-term yields.*

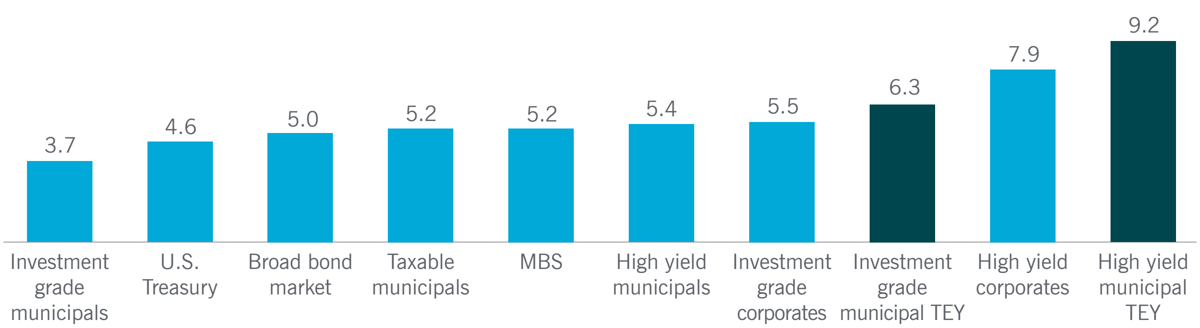
## MUNICIPAL BONDS OFFER ATTRACTIVE YIELDS

Aggressive Fed policy and a strong economy have boosted market yields to approximately 100 basis points above the trailing 10-year average. This means investors may maximize income at more attractive rates than in previous years.

Municipal bonds also offer an attractive taxable-equivalent yield (TEY) opportunity, as the interest earned is exempt from regular federal taxation and in some cases state and local taxes. For investors residing in high-tax locations such as California, New York State and New York City, TEY will be even more attractive.

### Figure 3: Muni yields are attractive vs. other broad fixed income sectors

*Yield to worst (%)*




Data source: Bloomberg, L.P., trailing 12 month returns from 31 Jan 2023 – 30 Jun 2024; yield to worst as of 30 Jun 2024. **Performance data shown represents past performance and does not predict or guarantee future results.** Yields are yield to worst. **Yield to worst** is the lowest potential yield that can be received on a bond without the issuer defaulting. **Representative indexes: Broad bond market:** Bloomberg U.S. Aggregate Bond Index; **High yield corporates:** Bloomberg U.S. Corporate High Yield Index; **High yield municipals:** Bloomberg High Yield Municipal Bond Index; **Investment grade corporates:** Bloomberg U.S. Corporate Investment Grade Index; **Investment grade municipals:** Bloomberg Municipal Bond Index; **Mortgage-backed securities (MBS):** Bloomberg MBS (fixed rate) Index; **Taxable municipals:** Bloomberg Taxable Municipal Bond Index; **U.S. Treasury:** Bloomberg U.S. Treasury Index; The taxable-equivalent yield is based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income (the net investment income tax). Individual tax rates may vary.

> ***Aggressive Fed policy and a strong economy have boosted market yields*** *to approximately 100 basis points above the trailing 10-year average.*

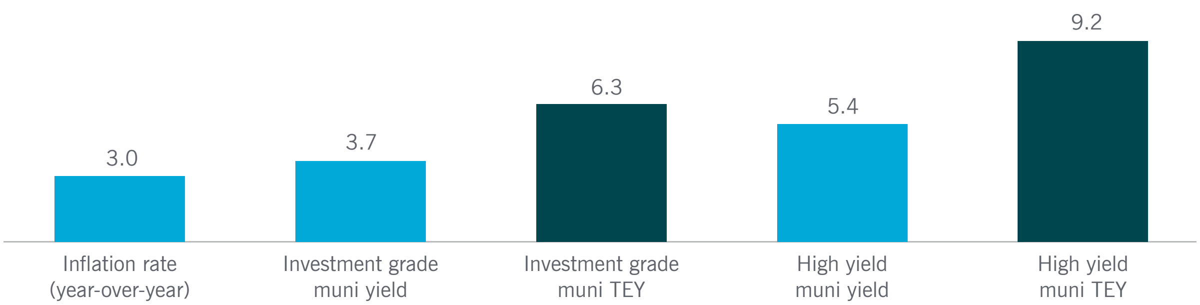
## REAL YIELDS ARE POSITIVE

Real yields — a bond's stated yield minus the inflation rate — sit near the highest levels since before the Great Financial Crisis. While inflation remains above central bank targets, it has moderated significantly. Real yields should remain attractive as central banks maintain higher interest rates while inflation continues to decline.

Municipal bond yields started 2024 at their highest level since 2011 and have only moved higher. In this environment, investors may enjoy attractive total returns from income alone, a dynamic absent for almost 10 years. Municipals do not need a meaningful rate rally or dramatic spread compression to offer outsized, equity-like returns.

### Figure 4: Municipal bond yields exceed inflation

*Yield to worst (%)*




Data source: Bloomberg, L.P., Bureau of Labor Statistics, 30 Jun 2024. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: inflation:** U.S. Consumer Price Index; **investment grade municipals:** Bloomberg Municipal Bond Index; **high yield municipals:** Bloomberg High Yield Municipal Bond Index. Yields are yield-to-worst. Yield to worst is the lowest potential yield that can be received on a bond without the issuer defaulting. The taxable-equivalent yield is based on the highest individual marginal federal tax rate of 37%, plus the 3.8% Medicare tax on investment income (the net investment income tax). Individual tax rates may vary.

> *In this environment, investors may enjoy attractive total returns from income alone, a dynamic absent for almost 10 years.*

## TECHNICAL IMBALANCES FAVOR MUNIS

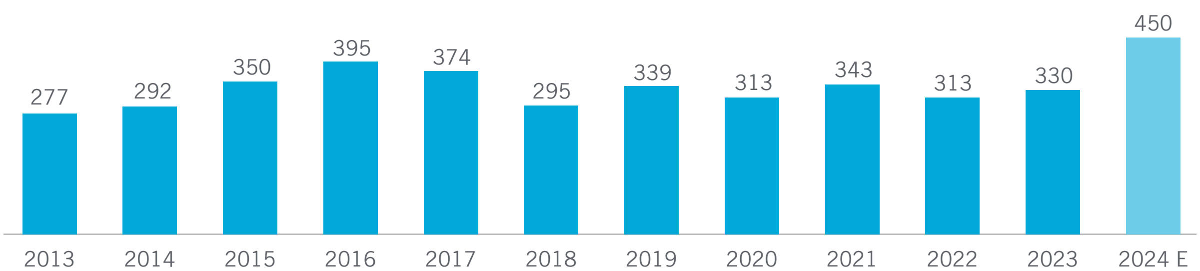
Municipal bond gross supply is expected to exceed $450 billion in 2024, up meaningfully from $330 billion in 2023. However, with approximately $400 billion of bonds maturing in 2024 and significant coupon payments, supply will likely be net neutral.

Increased issuance has resulted in a net positive supply in the first three quarters of 2024. However, issuance is projected to fall as we approach the U.S. election season, resulting in net negative supply for the remainder of the year. Demand should exceed supply, as proceeds from matured bonds will require investments in new bonds. And declining rates may result in other bonds being called early, with these additional reinvestment needs further increasing demand.

This supply/demand disparity should keep yields and spreads contained, as net negative supply creates scarcity among a shrinking pool of outstanding bonds.

### Figure 5: Gross municipal bond supply is expected to be higher in 2024

*Municipal bond issuance ($ billions)*




Data source: Securities Industry and Financial Markets Association (SIFMA.org), *U.S. Bond Market Issuance and Outstanding*, 31 Dec 2023. AMT municipal issuance is part of the tax-exempt municipal market. 2024 data is estimated, as of 30 Jun 2024.

> ***This supply/demand disparity should keep yields and spreads contained,*** *as net negative supply creates scarcity among a shrinking pool of outstanding bonds.*

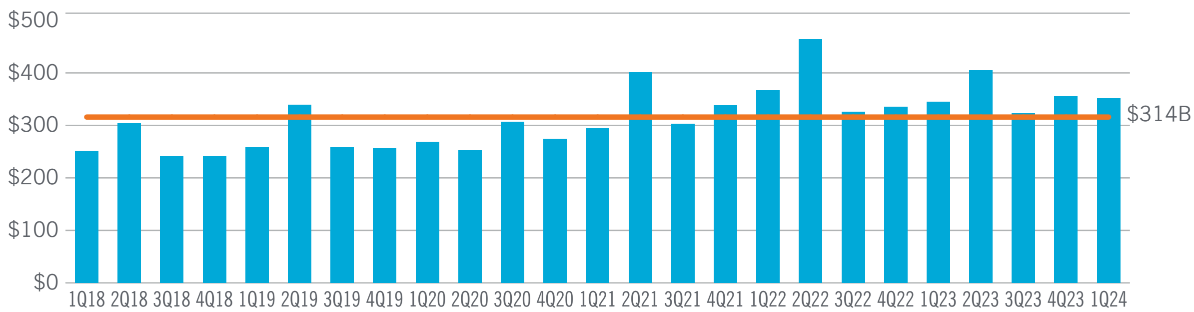
## MUNICIPAL BOND FUNDAMENTALS ARE STRONG

Municipal credit is in a strong position to weather potential economic uncertainty. State and local governments have high cash balances, and we expect munis to perform well in a risk-off environment due to their resilience during past economic downturns. In recent years, credit upgrades have outpaced downgrades by a factor of 2.5:1.

Municipal bonds should be well placed to capitalize on these solid fundamentals, and we think spreads can tighten further and provide total return potential.

**Figure 6: State tax revenue growth should normalize to pre-pandemic levels**

*National total sales tax revenue ($ billions)*




Data source: Nuveen; census.gov, 30 Jun 2024, with data as of 31 Mar 2024.

## MUNICIPAL BOND MARKET OUTLOOK

We believe the municipal market is well positioned as we end the year. The Fed's easing should bolster demand for municipal bonds. If investor sentiment shifts positively, as we expect, strengthening demand could absorb secondary market supply and act as a catalyst for capital appreciation. We see favorable conditions for municipal bonds, with attractive yields remaining and solid credit fundamentals for state and local governments. In this environment, we think municipal bonds have attractive potential in diversified, long-term portfolios.

**For more information, please visit nuveen.com.**

## Endnotes

This material is not intended to be a recommendation or investment advice, does not constitute a solicitation to buy, sell or hold a security or an investment strategy, and is not provided in a fiduciary capacity. The information provided does not take into account the specific objectives or circumstances of any particular investor, or suggest any specific course of action. Investment decisions should be made based on an investor's objectives and circumstances and in consultation with his or her financial professionals.

The views and opinions expressed are for informational and educational purposes only as of the date of production/writing and may change without notice at any time based on numerous factors, such as market or other conditions, legal and regulatory developments, additional risks and uncertainties and may not come to pass. This material may contain "forward-looking" information that is not purely historical in nature. Such information may include, among other things, projections, forecasts, estimates of market returns, and proposed or expected portfolio composition. Any changes to assumptions that may have been made in preparing this material could have a material impact on the information presented herein by way of example. **Performance data shown represents past performance and does not predict or guarantee future results.** Investing involves risk; principal loss is possible.

All information has been obtained from sources believed to be reliable, but its accuracy is not guaranteed. There is no representation or warranty as to the current accuracy, reliability or completeness of, nor liability for, decisions based on such information and it should not be relied on as such. For term definitions and index descriptions, please access the glossary on nuveen.com. **Please note, it is not possible to invest directly in an index.**

## Important information on risk

Investing involves risk; principal loss is possible. All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Investing in municipal bonds involves risks such as interest rate risk, credit risk and market risk. The value of the portfolio will fluctuate based on the value of the underlying securities. There are special risks associated with investments in high yield bonds, hedging activities and the potential use of leverage. Portfolios that include lower rated municipal bonds, commonly referred to as "high yield" or "junk" bonds, which are considered to be speculative, the credit and investment risk is heightened for the portfolio. Bond insurance guarantees only the payment of principal and interest on the bond when due, and not the value of the bonds themselves, which will fluctuate with the bond market and the financial success of the issuer and the insurer. No representation is made as to an insurer's ability to meet their commitments.

This information should not replace an investor's consultation with a financial professional regarding their tax situation. Nuveen is not a tax advisor. Investors should contact a tax professional regarding the appropriateness of tax-exempt investments in their portfolio. If sold prior to maturity, municipal securities are subject to gain/losses based on the level of interest rates, market conditions and the credit quality of the issuer. Income may be subject to the alternative minimum tax (AMT) and/or state and local taxes, based on the state of residence. Income from municipal bonds held by a portfolio could be declared taxable because of unfavorable changes in tax laws, adverse interpretations by the Internal Revenue Service or state tax authorities, or noncompliant conduct of a bond issuer. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager.

Nuveen, LLC provides investment solutions through its investment specialists.

This information does not constitute investment research as defined under MiFID.



nuveen
A TIAA Company

3968839-1225 1824341