Seelaus Asset Management
Municipal Bond Market Commentary

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A Memorable March and a Closer Look at Total Return

Here is one quick way to sum up the municipal bond market in the first quarter: munis in January and February roughly mirrored the movement of Treasury bond yields…and then March happened. In that month, a combination of factors caused municipal bond yields to go their own way and rise substantially, becoming somewhat disconnected from Treasury bond yields in the process.

The first thing we can say about this past March – or really any March (and early April too) – is that the usual seasonal pattern of waning demand for municipal bonds took hold. This is usually expected at this time of the year as investors often use redemptions from municipal bond portfolios to pay any taxes due. On top of this usual seasonal trend was a meaningful increase in new-issue bond supply this March, above the already high levels experienced in January and February. This somewhat weakened demand coupled with increased supply resulted in rising municipal bond yields, beyond the magnitude of movements in Treasury bond yields.

In addition to these fundamental forces, municipal bond yields were driven upward by the market beginning to consider the implications of possible changes to the tax-exemption of municipal bond interest. The tax-exemption issue has reared its head on a regular basis in the past four decades. It tends to emerge whenever Congress intensifies its search for federal government revenue-raisers and pay-fors during challenging budget seasons.

Whenever the issue of tax-exemption has emerged in the past, a bi-partisan chorus of mayors and governors has come together to educate and remind Congress of the critical role that low-cost tax-exempt financing plays in the state and local projects their constituents demand and appreciate. The easy answer to the current tax-exemption issue is that it will play out as it has in the past. But predicting how specific legislation will come out of the currently fraught political climate is tricky business. Will the exemption be left alone, scuttled entirely, or will only a portion of it be changed or limited in some way for certain investors? Will existing tax-exempt municipal bonds be grandfathered (very likely) from any change and how will that affect their value going forward? Will there be an increase in muni bond issuance as a change to the tax-exemption becomes more possible? The increase in new-issue muni bond supply in March can be partly attributed to issuers attempting to get ahead of a possible major change affecting their debt. When it comes to possible legislation, there are many questions and no sure answers. We can observe this: the extension of the 2017 tax cuts is a priority for the current administration and those ever-elusive, hotly debated revenue raisers and pay-fors are an area of heightened interest by lawmakers.

The municipal bond market digested all the above as well as a saw-tooth, upward-moving pattern of Treasury bond yields throughout March. As if this were not enough to consider, we have not even mentioned the late March uncertainty and concern over the imminent release of the current administration's tariff program. Months like March make for sometimes sloppy markets filled with volatile periods where participants grope for proper levels. The muni bond market in March was certainly that kind of month. It was also as good a month as any to re-examine the idea of total return and the part it plays in all the investment goals municipal bond investors strive to achieve.

Simply put, total return reflects the change in value of a security or portfolio from the beginning of a certain period to the end, measured usually on a monthly, quarterly, or annual basis. For bondholders, the change in value will include any increase or decrease in the bond's price plus any coupon income collected or any interest income accrued. When bond yields rise, bond prices will fall, possibly enough to generate a negative total return for a particular time period. Bondholders, of course, have an interest in the ongoing value and volatility of their investments and total return provides useful information on that score.

When examining monthly or quarterly total returns, whatever they may be, it is important for bond investors to remember that they invest in bonds to achieve a variety of objectives. Primarily among these objectives for many bond investors is the generation of attractive levels of income or yield. A negative total return for any given month does not change the original price an investor has paid for a bond, and it doesn't change the yield to maturity (or call) one has captured over the life of that bond. Capturing attractive yields beyond the ordinary but within the context of overall safety and low interim volatility is a broadly stated objective for many bond investors. It remains a guiding light for how we approach the muni bond portfolios we manage. Periodic measurements of total return provide useful information on interim values and volatility. We suggest they be viewed in conjunction with all the measurements of bond satisfaction and all the objectives investors are trying to achieve.

In these volatile times, we continue to believe in the long-term effectiveness of seeking to capture value and spread at various points of the short/intermediate yield curve and at various points in the interest rate cycle. Tracking every 2025 tax-exempt muni bond purchase we have made for our clients in our intermediate muni bond strategy through 4/7/2025, we have captured an average yield to call of 91 basis points and an average yield to maturity of 103 basis points *above* similar maturity, standard high-grade triple A muni bond scales. All bond purchases were investment grade rated with maturities of 15 years and under, an average rating of single A, an average maturity of 8 years, and an average call of 3 years.

By early April, municipal bond yields in the intermediate maturity range declined sharply to erase some of the recent March increase. Currently, single A-rated municipal bonds in the attractive 10 to 15-year range offer yields of 3.80% to 4.25% tax-free, or a 6.03% to 6.75% taxable equivalent yield for top tax bracket investors. We continue, as always, to use careful judgment on the pace at which we invest cash. We remain committed to our dogged and judicious search for value in the investment grade, intermediate maturity space of the municipal bond market.

Tom Dalpiaz, Portfolio Manager – Municipal Bonds

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- *Authentic*

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To learn more about our investment offerings, please call 212-935-0755, email ir@seelausam.com or visit https://www.rseelaus.com/asset-management/

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