DECEMBER 2023

PIMCO

Monthly Municipal Market Update

Executive Summary

- Municipals experienced their strongest two-month performance since 1986 during the final two months of 2023.
- Municipal yields remain attractive: The Bloomberg Municipal Bond Index offers 93 basis points additional yield over its 10-year average.
- We believe municipal credit fundamentals remain exceptionally strong.

Municipal bond performance in focus: Exploring the end-of-year rally and municipal landscape entering 2024

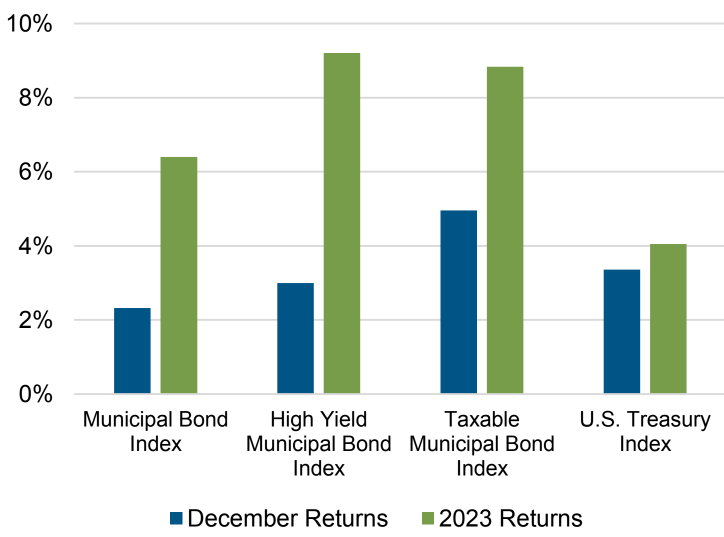
At the end of October, the Bloomberg Municipal Bond Index was down 2.22% year-to-date. Over the two months that followed, the asset class rallied by an impressive 8.82%, propelling the index to a 6.40% gain for 2023. This substantial turnaround resulted in the index's strongest two-month performance since 1986.[1] Meanwhile, Bloomberg's High Yield Municipal Bond Index returned 9.21% over the calendar year, and the Bloomberg Taxable Municipal Bond Index gained 8.84%. For comparison, the Bloomberg U.S. Treasury Index advanced by 4.05% for the year.[2]

Even as municipal bonds have rallied, we believe yields within the asset class remain attractive. Entering the new year, the Bloomberg Municipal Bond Index offered a 3.22% yield to worst, a figure which is more than 90 basis points (bps) higher than the index's 10-year average.[3] For individual investors subject to the highest federal income tax bracket, this figure translates to a taxable-equivalent yield of 5.43%.

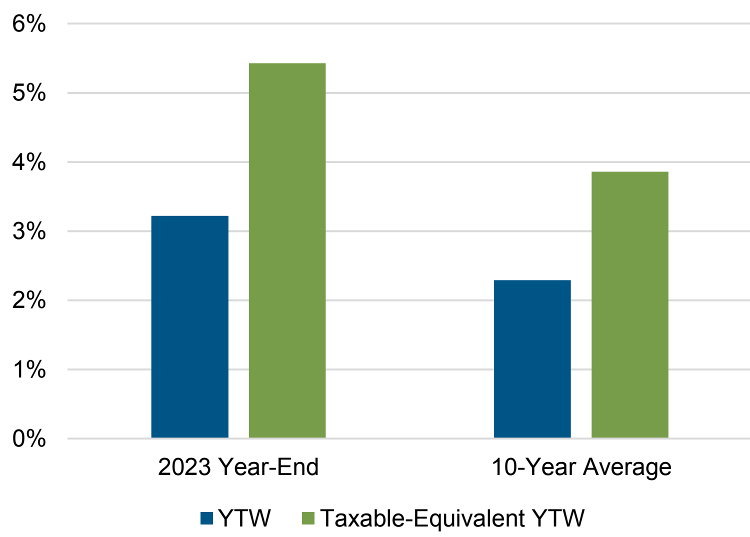
In 2024, we believe that market technicals – which have presented headwinds for much of the past two years – may turn supportive and could ultimately serve as a performance driver. Municipal bond mutual fund and ETF flows finished 2023 in net negative territory for the second consecutive year; however, flows did turn positive toward the end of December.[4] Should investor sentiment continue to strengthen and result in a sustained period of inflows, municipals would be positioned strongly.

Finally, as we discussed in our previous update, we believe municipal credit fundamentals remain exceptionally strong. The median state rainy day fund currently sits at 12% of expenditures versus a median of 4% from 2000 to 2018.[5] Additionally, many local governments are sitting on historically high levels of reserves, which are augmented by remaining federal aid funds that will be spent down through 2026. In summary, we believe municipals are very well positioned as we enter 2024.

Bloomberg Index Returns



Bloomberg Municipal Bond Index Yield to Worst



Notes: Taxable-equivalent yield assumes 37% federal income tax and 3.8% Medicare investment tax. **Sources**: Municipal index returns and yields: Bloomberg as of 29 Dec 2023.

IMPORTANT NOTICE: Please note that the following contains the opinions of the manager as of the date noted, and may not have been updated to reflect real-time market developments. All opinions are subject to change without notice.

Month in review

- The Fed left interest rates unchanged for the third straight time. Given that inflation has declined more rapidly than policymakers had anticipated, the central bank has now turned its attention to rate cuts and is currently projecting three 25-bp cuts in 2024.[6]
- Both municipal and Treasury yields declined across the curve, while municipal/Treasury ratios richened except at the 30-year tenor. The 10-year AAA MMD yield fell -35 bps to close the month at 2.28%, while the 10-year Treasury yield closed down -48 bps at 3.86%.[7]
- December's rate movements drove solid returns for fixed income: The Bloomberg Municipal Bond Index gained 2.32% (6.40% YTD) and the Bloomberg U.S. Treasury Index advanced by 3.36% (4.05% YTD). Meanwhile, Bloomberg's High Yield Municipal Bond and Taxable Municipal Bond indices increased by 3.00% (9.21% YTD) and 4.96% (8.84% YTD), respectively.[8]
- New issuance in December totaled $24 billion, down $13 billion from November but exceeding December 2022's figure of $22 billion.[9]
- Municipal bond mutual fund and ETF flows turned positive toward the end of December. However, fund and ETF flows finished 2023 in net negative territory for the second consecutive year.[10]
- The January effect, a municipal market phenomenon in which asset prices tend to appreciate due to seasonal supply/demand imbalances, may propel municipals to additional gains in the coming month. Over the past 15 years, municipals have experienced positive returns an impressive 12 times during January.[11] However, last month's lighter-than-average December sales calendar and lower rates relative to just a few months ago may lead to increased issuance this month, which could have a dampening effect on the phenomenon.

Market Snapshot

	Muni yields (AAA MMD)			U.S. Treasury yields			Muni taxable equivalent*	
	Yield	MTD change	YTD change	Yield	MTD change	YTD change	Yield	Spread
2-year	2.52%	-0.32%	-0.08%	4.26%	-0.44%	-0.15%	4.26%	-0.00%
5-year	2.28%	-0.31%	-0.24%	3.84%	-0.44%	-0.18%	3.85%	+0.01%
10-year	2.28%	-0.35%	-0.35%	3.86%	-0.48%	-0.02%	3.85%	-0.01%
30-year	3.42%	-0.35%	-0.16%	3.99%	-0.52%	0.03%	5.78%	+1.79%

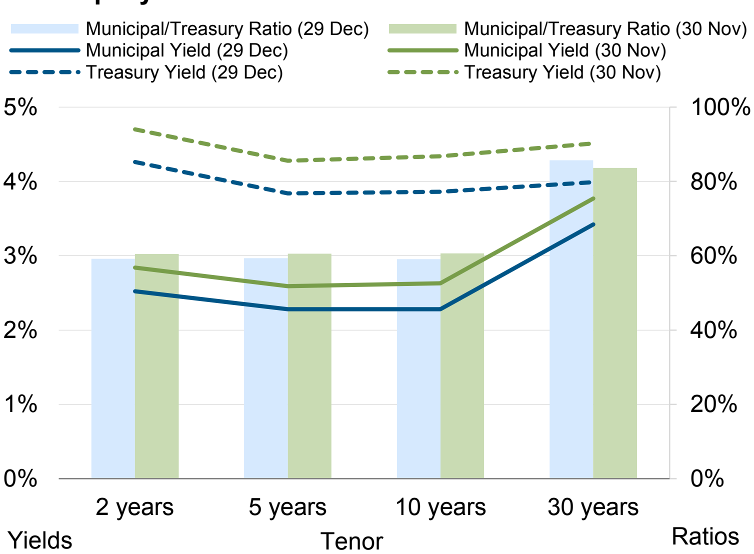
Municipal index returns

Muni returns	YTW	MTD	YTD
Bloomberg Muni Index	3.22%	2.32%	6.40%
Bloomberg High Yield Muni	5.57%	3.00%	9.21%
Bloomberg Taxable Muni	4.86%	4.96%	8.84%
Bloomberg 1–10 (1–12)	2.76%	1.63%	4.61%
Bloomberg Muni Short (1–5)	2.79%	0.95%	3.58%

Monthly new issuance (in millions)

Month	2023	2022	2021
July	$28,343	$28,268	$38,645
August	$39,469	$41,722	$46,469
September	$30,862	$27,251	$46,183
October	$38,958	$29,679	$44,182
November	$36,574	$26,715	$39,120
December	$23,842	$22,272	$44,122
YTD	**$383,666**	**$405,472**	**$506,667**

Municipal yields and ratios



Long-term municipal mutual fund net flows (in millions)

Month	2023	2022	2021
July	$436	$69	$10,182
August	($1,967)	($1,929)	$9,209
September	($6,631)	($14,583)	$5,691
October	($10,598)	($17,667)	$1,791
November	($3,219)	($9,923)	$4,877
December	($772)	($16,180)	$2,155
YTD	**($18,041)**	**($148,436)**	**$83,515**

Notes: Figures for total municipal issuance and taxable municipal issuance include both municipal CUSIPs and not-for-profit corporate CUSIPs. *Taxable-equivalent yield assumes 37% federal income tax and 3.8% Medicare investment tax. Spread refers to spreading the municipal taxable equivalent yield against the U.S. Treasury yield.

Sources: Yield and spread data: Thomson Reuters as of 29 Dec 2023; Municipal Index Returns: Bloomberg as of 29 Dec 2023; Muni CUSIP issuance sourced from The Bond Buyer, including bond and note issuance, as of 29 Dec 2023. Not-for-profit corporate CUSIP issuance based on PIMCO analysis of Bloomberg data sourced on 2 Jan 2024, but as of 29 Dec 2023; Muni fund flows: Investment Company Institute Long-Term Mutual Fund Net New Cash Flow published 27 Dec 2023 with data up to 20 Dec 2023. The most recent two months' flows are based on weekly estimates and are subject to change.

[1] Bloomberg, 29 Dec 2023

[2] Ibid

[3] Ibid

[4] Investment Company Institute, Long-Term Mutual Fund and Exchange-Traded Fund (ETF) Flows, 20 Dec 2023

[5] NASBO, Fiscal Survey of States, Fall 2023

[6] Nick Timiraos, "Fed Begins Pivot Toward Lowering Rates as Inflation Declines," Wall Street Journal, 13 Dec 2023

[7] Thomson Reuters TM3 MMD Interactive Data, 29 Dec 2023

[8] Bloomberg, 29 Dec 2023

[9] The Bond Buyer: Primary Market Statistics – A Decade of Bond Finance, 29 Dec 2023; Bloomberg Corporate Issued Municipals Data, 29 Dec 2023

[10] Investment Company Institute, Long-Term Mutual Fund and Exchange-Traded Fund (ETF) Flows, 20 Dec 2023

[11] Bloomberg, 29 Dec 2023

Past performance is not a guarantee or a reliable indicator of future results.

Investing in **municipal bonds** involves the risks of investing in debt securities generally and certain other risks. Investors will, at times, incur a tax liability. Income from municipal bonds is exempt from federal income tax and may be subject to state and local taxes and at times the alternative minimum tax. Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and low interest rate environments increases this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed.

The credit quality of a particular security or group of securities does not ensure the stability or safety of an overall portfolio. The quality ratings of individual issues/issuers are provided to indicate the credit-worthiness of such issues/issuer and generally range from AAA, Aaa, or AAA (highest) to D, C, or D (lowest) for S&P, Moody's, and Fitch respectively.

Statements concerning financial market trends or portfolio strategies are based on current market conditions, which will fluctuate. There is no guarantee that these investment strategies will work under all market conditions or are appropriate for all investors and each investor should evaluate their ability to invest for the long term, especially during periods of downturn in the market. Outlook and strategies are subject to change without notice.

Yield to Worst (YTW) is the estimated lowest potential yield that can be received on a bond without the issuer actually defaulting.

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Charts are provided for illustrative purposes and are not indicative of the past or future performance of any PIMCO product.

Bloomberg Municipal Bond Index consists of a broad selection of investment-grade general obligation and revenue bonds of maturities ranging from one year to 30 years. It is an unmanaged index representative of the tax-exempt bond market. The index is made up of all investment grade municipal bonds issued after 12/31/90 having a remaining maturity of at least one year. The **Bloomberg High Yield Municipal Bond Index** measures the non-investment grade and non-rated U.S. tax-exempt bond market. It is an unmanaged index made up of dollar-denominated, fixed-rate municipal securities that are rated Ba1/BB+/BB+ or below or non-rated and that meet specified maturity, liquidity, and quality requirements. The **Bloomberg Taxable Municipal Index** represents a rules-based, market-value weighted index engineered for the long-term taxable bond market. For inclusion in the Index, bonds must be rated investment grade quality or better, have at least one year to maturity, have a coupon that is fixed rate, have an outstanding par value of at least $7 million, and be issued as part of a transaction of at least $75 million. The Intermediate Municipal subsector groups together securities with an average maturity between one to 10 years. The **Bloomberg 1-10 Year Municipal Bond Index** is an unmanaged index considered to be generally representative of investment-grade municipal issues having remaining maturities from 1-10 years and a national scope. The **Bloomberg Muni Short (1-5) Index** is the Muni Short (1-5) component of the Bloomberg Municipal Bond Index. The **Bloomberg U.S. Treasury Index** is a measure of the public obligations of the U.S. Treasury. **Bloomberg U.S. Aggregate Index** represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. It is not possible to invest directly in an unmanaged index.

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