

Monthly Municipal Market Update

Month in review

Following September's worst month of losses for U.S. equities since the beginning of the pandemic, all three major U.S. stock market indices closed October at record highs, supported by a strengthening global economic recovery.¹ Meanwhile, October brought volatility to the bond market, and the Treasury yield curve ultimately flattened. Yields at tenors out to 10 years increased, while yields beyond the 10-year tenor decreased. At month end, the 1-, 5-, 10-, and 30-year tenors of the Treasury curve yielded 0.13% (up 5 basis points), 1.19% (up 20 basis points), 1.56% (up 3 basis points), and 1.94% (down 15 basis points), respectively.²

The AAA Municipal Market Data (MMD) yield curve also flattened in October; however, yields increased at all tenors of the curve. Yields inside the 10-year tenor rose 2 basis points (bps) to 14 bps; yields from the 10-year tenor to the 19-year tenor rose 3 bps to 7 bps; and yields at the 20-year tenor and beyond each increased by 2 bps. The 10-year tenor of the benchmark muni yield curve closed October at 1.21%, an increase of 7 bps from September's final print.³ Weekly reporting municipal bond mutual funds added four more consecutive weeks of inflows in October; however, these inflows added up to just \$1.1 billion for the month compared to September's \$4.3 billion. Municipal bond funds have added \$91.4 billion year to date.⁴ Meanwhile, municipal issuance totaled just \$38.4 billion in October, the lowest figure since July.⁵

The Federal Open Market Committee (FOMC) held its most recent policy meeting in the first week of November. Fed Chair Jerome Powell announced the central bank's plans to begin unwinding its roughly \$120 billion in monthly purchases of Treasury and mortgage securities in November. The Fed began

its asset purchase program early in the pandemic to help stabilize markets and hold longer-term rates down. However, amid the recent inflation surge, the Fed will look to scale purchases back by \$15 billion each month for the remainder of the year. The pace of monthly reductions beyond that will likely be similar, as the Fed seeks to phase out the program entirely by June 2022, but Fed officials note they are prepared to adjust the pace "if warranted by changes in the economic outlook." Fed officials have indicated they do not wish to raise the benchmark interest rate until after their asset purchases have ended.⁶

- Performance varied between tax-exempt municipal bonds and taxable municipal bonds in October. While the Bloomberg Municipal Bond Index returned -0.29% and the Bloomberg High Yield Municipal Bond Index returned -0.41% over the month, the Bloomberg Taxable Municipal Bond Index gained 0.39%. October's performance brings year-to-date total returns for the three indices to 0.50%, 6.10%, and 0.89%, respectively.⁷
- Municipal/Treasury ratios beyond the 3-year tenor have become more attractive as a result of recent rate movements, with the ratio between 10-year AAA munis and 10-year Treasuries closing October at nearly 78%. Similarly, taxable-equivalent spreads from AAA municipal bonds to Treasuries increased at tenors beyond 3 years in October.^{8**}
- With 631,000 total trades and \$189 billion in par traded, the secondary market in October experienced its most active month since June. This trend is not atypical as we exit the summer months and enter the year's final quarter.⁹

Figure 1: Market snapshot

| | Muni yields (MMD AAA) | | | U.S. Treasury yields | | | Muni taxable equivalent** | |
|---------|-----------------------|------------|------------|----------------------|------------|------------|---------------------------|--------|
| | Yield | MTD change | YTD change | Yield | MTD change | YTD change | Yield | Spread |
| 2-year | 0.25% | 0.08% | 0.11% | 0.49% | 0.20% | 0.37% | 0.42% | -0.07% |
| 5-year | 0.64% | 0.14% | 0.42% | 1.19% | 0.20% | 0.83% | 1.08% | -0.11% |
| 10-year | 1.21% | 0.07% | 0.50% | 1.56% | 0.03% | 0.64% | 2.04% | 0.48% |
| 30-year | 1.69% | 0.02% | 0.30% | 1.94% | -0.15% | 0.29% | 2.85% | 0.91% |

| | | | | | | |
|-------------------|-------------------|---------------------|---------------|---------------|-------------------------------|-----------------------------------|
| \$413.1B | -\$7.3B | +\$91.4B | +0.50% | +6.10% | +50 bps | +64 bps |
| YTD muni issuance | M/M muni issuance | YTD muni fund flows | YTD IG return | YTD HY return | YTD change in 10yr muni yield | YTD change in 10yr Treasury yield |

*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: Muni CUSIP Issuance: The Bond Buyer, including bond and note issuance. Not-for-profit corporate CUSIP issuance: PIMCO analysis of Bloomberg data. Yield and spread data: Thomson Reuters. Muni fund flows: Refinitiv Lipper, inclusive of weekly and monthly reporting funds. YTD IG return: Bloomberg Municipal Bond Index. YTD HY return: Bloomberg High Yield Municipal Bond Index. All data as of 31 Oct 2021 except for muni fund flows which is as of 27 Oct 2021 and not-for-profit corporate CUSIP issuance which was sourced on 3 Nov 2021, but as of 31 Oct 2021.

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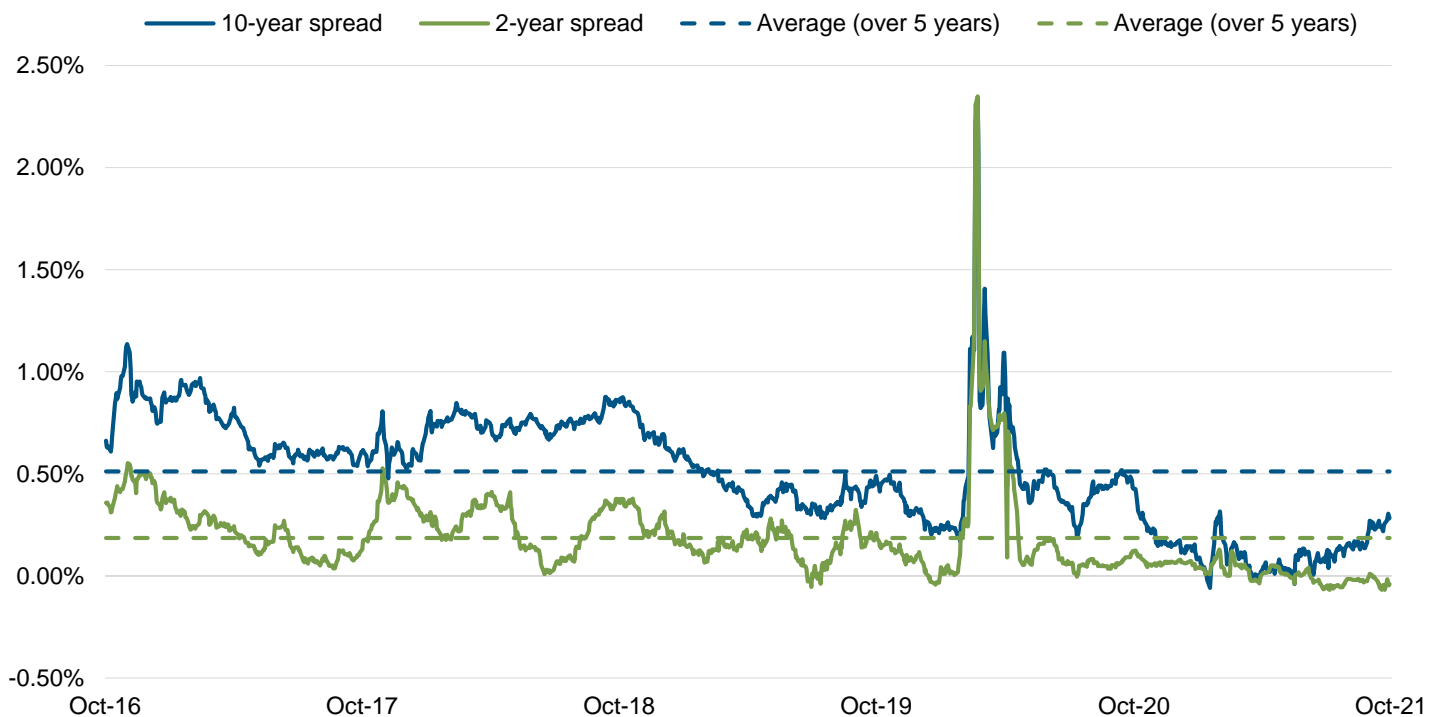
Muni technicals in focus: Munis pull back as investors await broader market developments

The VIX volatility index tumbled in October to its lowest level since the pandemic began – even with market participants largely anticipating a November tapering announcement by the Federal Reserve.¹⁰ Equity markets rallied on strong quarterly corporate earnings, though details in the reports surrounding continued supply chain bottlenecks signaled that above-target inflation may persist.¹¹ Given this macroeconomic backdrop and expected central bank tightening, global bond yield curves generally flattened in October.¹² In line with broader fixed income market weakness, municipal bids-wanted surged to as much as 6,000 per day, their highest level since March.¹³ Ultimately, municipals retreated from their rather expensive valuations, with the 10-year municipal/Treasury ratio increasing to about 77.7% by month-end.¹⁴ As municipal yields rose over the month, the Bloomberg Municipal Bond Index returned -0.29%, while the Bloomberg High Yield Municipal Bond Index returned -0.41%.¹⁵

While seasonal trends would generally prompt elevated issuance in October, monthly municipal volume was a moderate \$38.4 billion as municipal issuers awaited fiscal policy developments.¹⁶ As rates continued to drift upward, monthly taxable issuance collapsed by 60% from last October.¹⁷ Demand for municipals persisted, with weekly reporting municipal bond mutual funds totaling approximately \$1.1 billion of inflows over the month, though this figure was notably lower than in recent months.¹⁸ Nevertheless, we believe that municipal market fundamentals are strong and currently present compelling [investment opportunities](#).

We continued to observe evidence of strong underlying credit fundamentals in October amid recovery from the pandemic, including growth in return-to-office numbers in most metropolitan regions. Some of the hardest-hit metropolitan areas, such as New York City and San Francisco, are now approaching or surpassing 30% office occupancy, while other major cities are now hitting 50% occupancy.¹⁹

Figure 2: Municipal/Treasury after-tax* spreads



Sources: Figure 2: Thomson Reuters TM3 MMD Interactive as of 31 Oct 2021. 2-year and 10-year average spreads calculated over the last five years, starting 1 Nov 2016. *Assuming a 37% federal income tax rate and 3.8% Medicare tax rate.

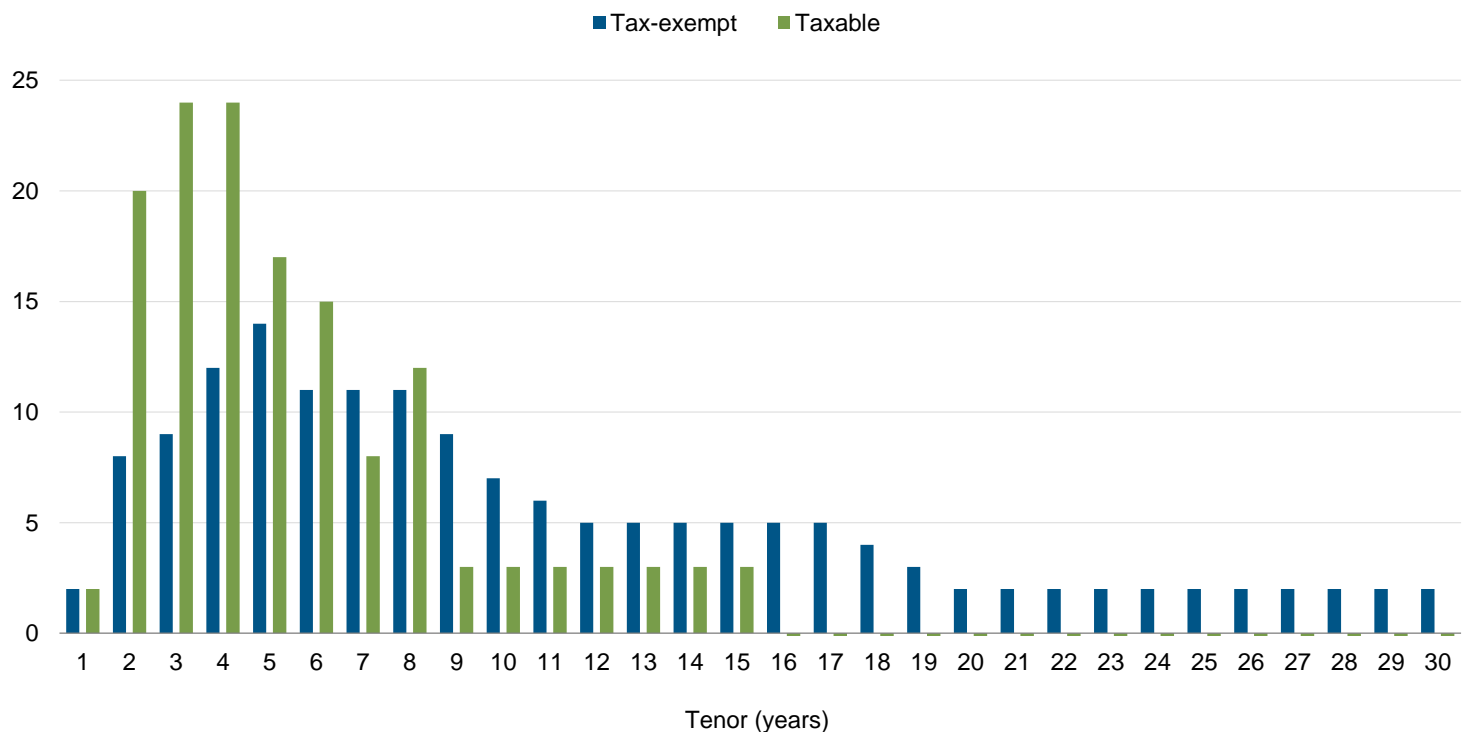
State revenue trends continued their steady march upward, highlighted in the past month by New Jersey reporting first quarter tax revenues up by 30% over the same period last year; New York’s collections tracking \$7.2 billion ahead of budget through the first six months of its fiscal year; and California suggesting it may post another historic budget surplus this year, as revenues are exceeding estimates by more than 22%.²⁰

There has been continued positive momentum for many municipals that entered the pandemic with significant credit issues. Fitch revised its outlook on Chicago to stable from negative, recognizing the city’s ability to pass a fiscal year 2022 budget that closed an initial gap of more than \$733 million through

a mixture of increased revenues, federal funds, and spending cuts while also increasing its pension funding to all four city plans.

Notably, the Commonwealth of Puerto Rico’s governor signed into law debt legislation authorizing the island to issue new bonds, including a contingent value instrument. The new debt instruments are part of a consideration package that certain classes of creditors, including owners of general obligation (GO) debt and Puerto Rico Highways and Transportation Authority debt, will receive in exchange for their defaulted debt when the island exits bankruptcy. Bankruptcy confirmation hearings are scheduled to begin 8 November, and the island may exit bankruptcy before year-end.

Figure 3: Month-over-month change in AAA MMD yields (bps)



Sources: Figure 3: Thomson Reuters TM3 MMD Interactive as of 31 Oct 2021.

Figure 4: Market data**Municipal index returns**

| Muni returns | YTW | MTD | YTD |
|----------------------------|-------|--------|-------|
| Bloomberg Muni Index | 1.21% | -0.29% | 0.50% |
| Bloomberg High Yield Muni | 3.21% | -0.41% | 6.10% |
| Bloomberg Taxable Muni | 2.27% | 0.39% | 0.89% |
| Bloomberg 1-10 (1-12) | 0.78% | -0.28% | 0.07% |
| Bloomberg Muni Short (1-5) | 0.49% | -0.14% | 0.27% |

Source: Bloomberg as of 31 Oct 2021

Monthly municipal fund net flows (in millions)

| Month | 2021 | 2020 | 2019 |
|-----------|----------|----------|---------|
| May | \$5,482 | \$5,144 | \$7,682 |
| June | \$9,155 | \$11,175 | \$6,398 |
| July | \$10,182 | \$9,495 | \$8,976 |
| August | \$9,209 | \$10,546 | \$7,778 |
| September | \$5,696 | \$6,174 | \$4,873 |
| October | \$1,470 | \$5,732 | \$7,151 |

Source: Investment Company Institute as of 3 Nov 2021. The most recent month's flows are based on weekly estimates and subject to change.

Average monthly visible supply (in millions)

| Month | 2021 | 2020 | 2019 |
|-----------|----------|----------|----------|
| May | \$10,815 | \$11,498 | \$8,232 |
| June | \$12,509 | \$13,413 | \$8,492 |
| July | \$10,590 | \$13,401 | \$8,289 |
| August | \$9,848 | \$14,758 | \$11,063 |
| September | \$11,410 | \$14,675 | \$11,945 |
| October | \$12,352 | \$19,109 | \$14,175 |

Source: Bloomberg as of 31 Oct 2021

Secondary market activity (in millions)

| Month | Average par of Bloomberg pick | Average daily bid wanted |
|--------|-------------------------------|--------------------------|
| Oct-20 | \$3,471 | \$700 |
| Nov-20 | \$2,737 | \$479 |
| Dec-20 | \$4,998 | \$536 |
| Jan-21 | \$6,830 | \$559 |
| Feb-21 | \$7,662 | \$713 |
| Mar-21 | \$6,879 | \$653 |
| Apr-21 | \$6,916 | \$564 |
| May-21 | \$7,643 | \$569 |
| Jun-21 | \$7,906 | \$537 |
| Jul-21 | \$6,821 | \$396 |
| Aug-21 | \$6,642 | \$485 |
| Sep-21 | \$7,485 | \$513 |
| Oct-21 | \$8,344 | \$648 |

Source: Bloomberg as of 31 Oct 2021

10-year municipal vs. 10-year Treasury yields

| Day | Municipal | Treasury |
|------------|-----------|----------|
| 9/30/2021 | 1.14 | 1.53 |
| 10/31/2021 | 1.21 | 1.56 |

Source: Thomson Reuters as of 31 Oct 2021

Monthly new issuance (in millions)

| Month | 2021 | 2020 | 2019 |
|-----------|----------|----------|----------|
| May | \$35,430 | \$37,010 | \$29,512 |
| June | \$52,964 | \$57,542 | \$37,386 |
| July | \$38,321 | \$49,702 | \$30,258 |
| August | \$44,530 | \$48,338 | \$43,268 |
| September | \$45,726 | \$54,613 | \$38,082 |
| October | \$38,380 | \$83,850 | \$61,478 |

Source: Muni CUSIP issuance sourced from The Bond Buyer, including bond and note issuance, as of 31 Oct 2021. Not-for-profit corporate CUSIP issuance based on PIMCO analysis of Bloomberg data sourced on 3 Nov 2021, but as of 31 Oct 2021.

Monthly bond redemptions (in millions)

| Month | Amount matured | Amount called |
|--------|----------------|---------------|
| Nov-20 | \$27,353 | \$4,941 |
| Dec-20 | \$33,403 | \$9,509 |
| Jan-21 | \$21,900 | \$4,706 |
| Feb-21 | \$28,728 | \$4,485 |
| Mar-21 | \$26,080 | \$5,861 |
| Apr-21 | \$22,270 | \$5,755 |
| May-21 | \$25,714 | \$4,083 |
| Jun-21 | \$45,424 | \$8,574 |
| Jul-21 | \$39,400 | \$7,761 |
| Aug-21 | \$48,278 | \$6,838 |
| Sep-21 | \$21,750 | \$5,183 |
| Oct-21 | \$29,108 | \$6,375 |

Source: Bloomberg as of 31 Oct 2021

Sector returns

| Select sectors | Oct '21 | YTD | 2020 |
|------------------------|---------|--------|--------|
| General obligation | -0.27% | 0.03% | 5.49% |
| Pre-refunded | -0.15% | -0.10% | 2.76% |
| Revenue | -0.31% | 0.75% | 5.31% |
| Education | -0.25% | 0.53% | 5.39% |
| Healthcare | -0.39% | 1.50% | 5.70% |
| Industrial development | -0.43% | 0.50% | 5.46% |
| Lease-backed | -0.40% | 1.29% | 5.04% |
| Power | -0.26% | 0.15% | 5.40% |
| Special tax | -0.21% | 0.57% | 4.73% |
| Transportation | -0.38% | 1.17% | 5.16% |
| Water & sewer | -0.20% | -0.17% | 5.86% |
| HY tobacco | -0.83% | 5.40% | 13.93% |
| HY Puerto Rico | -0.97% | 5.02% | 10.68% |

Source: Bloomberg Indices as of 31 Oct 2021

¹ Maggie Fitzgerald, "Dow and S&P 500 close at records to start November, small caps post best day since August," CNBC, published 31 Oct 2021, updated 1 Nov 2021

² Thomson Reuters TM3 MMD Interactive Data, 29 Oct 2021

³ Ibid

⁴ Refinitiv Lipper, 27 Oct 2021. Data is inclusive of weekly reporting funds and does not include monthly reporting funds

⁵ The Bond Buyer: Primary Market Statistics – A Decade of Bond Finance, 29 Oct 2021; Bloomberg, 3 Nov 2021

⁶ Nick Timiraos, "Fed Dials Back Bond Purchases, Plots End to Stimulus by June," Wall Street Journal, 3 Nov 2021

⁷ Bloomberg, 29 Oct 2021

⁸ Thomson Reuters TM3 MMD Interactive Data, 29 Oct 2021

⁹ The Bond Buyer: Secondary Market Data, 3 Nov 2021

¹⁰ Bloomberg, 29 Oct 2021

¹¹ Joe Wallace and Akane Otani, "Stocks Finish Best Week in Months After Strong Earnings Reports," Wall Street Journal, 15 Oct 2021

¹² Tommy Stubbington and Katie Duguid, "Bad bets trigger waves of tumult in short-term bond markets," Financial Times, 29 Oct 2021

¹³ Bloomberg, 29 Oct 2021

¹⁴ Thomson Reuters TM3 MMD Interactive Data, 29 Oct 2021

¹⁵ Bloomberg, 29 Oct 2021

¹⁶ The Bond Buyer, "Bond Sales (Latest Month)," 29 Oct 2021

¹⁷ Ibid

¹⁸ Refinitiv Lipper, 27 Oct 2021. Data is inclusive of weekly reporting funds and does not include monthly reporting funds

¹⁹ Scott M. Stringer. "New York by the Numbers Monthly Economic and Fiscal Outlook," 1 Nov 2021

²⁰ NJ Department of Treasury, "September Revenue Collections Up Again," 15 Oct 2021; Thomas P. Dinapoli, "State Tax Receipts Exceed Initial Projections By \$7.2 Billion Through First Six Months," 15 Oct 2021; Keeley Bosler, "October Finance Bulletin 2021," Oct 2021

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