New York Life Investments

# Muni Market Update with MacKay Municipal Managers™

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**Volatility Hits Munis – But It's Technical, Not Fundamental**

The municipal market experienced a sharp reversal following a brief rally. What began as a flight-to-quality alongside Treasuries turned into broad-based risk-off selling. The pressure picked up on Friday afternoon and intensified into Monday, with bid wanted activity reaching levels not seen since the pandemic. This was not a credit event—all credits sold off, including AAA-rated bonds—driven instead by technical pressure and temporary impairment.

**ETFs and Mutual Funds Amplified the Pressure**

Passive ETF flows were a dominant source of outflows, creating a technical imbalance in the market. ETFs, due to their liquidity, allowed clients to move quickly in and out, contributing to abrupt selling. Mutual funds added to the pressure, as many are fully invested or use leverage. When redemptions hit, they became indiscriminate sellers, selling the most liquid bonds they could.

**Liquidity Stress Creates Opportunity for Active Investors**

In this type of environment, there is an opportunity to take advantage of dislocations. Investors not forced to sell can restructure portfolios to be additive to the income component and total return characteristics. These types of moves can be made without losing exposure to the market and can help offset mark-to-market declines. New incremental dollars or marginal dollars are the easiest way to take advantage, but portfolio restructuring also makes sense when the market moves 50 to 100 basis points.

**High Yield Holding Up—for Now**

High yield has outperformed investment grade so far this year, largely due to income, with credit spreads holding in. The market hasn't experienced the blowout seen in the taxable high yield space. However, less liquid and more esoteric parts of the market have not yet fully repriced, and some portfolios have not yet marked their bonds. There is strong demand and a lack of supply in high yield, but going forward, there may be less enthusiasm as investors consider compelling yields in high grade.

**Ratios Are Flashing Value**

Ratios of AAA-rated muni yields to Treasuries are highlighting value. The long end of the muni market is trading at 100% of comparable Treasury yields—well above the typical 85%. High-grade munis have underperformed Treasuries by about 75 basis points year-to-date. The market is already discounting potential moves in Treasury yields, making long-end municipals appear very attractive.

**Supply Is Rising, But Seasonals Could Offer Support**

Supply is elevated due to the reduced federal support and state and local governments pushing forward with projects. The municipal market is beginning to grow again after years of remaining around $4 trillion. Many clients are still underweight municipals. With tax-related selling nearly behind us and strong seasonal demand expected from May through July, the technical picture could shift quickly.

**Policy Uncertainty Remains, But Tax-Exempt Status Looks Safe**

There is talk around reduced federal outlays and changes to tax policy, including the potential impact on Medicaid and hospitals. While there's mention of eliminating the tax-exempt status of munis, this is viewed as a low-probability outcome. The estimated $35 billion cost doesn't result in meaningful federal savings, and raising borrowing costs would be politically difficult.

**Where the Team is Finding Value Now**

Everything is for sale in this market, and that creates broad opportunity. High-grade investment grade bonds are expected to snap back first. The new issue market offers great value, with issuers still bringing deals and providing wider spreads, higher coupons, and better structures. There's also opportunity to move from a slightly short to neutral or modestly long duration stance without wholesale portfolio changes.

**Final Thought**

This is not a municipal credit concern—it is a technical event. While painful in the short term, it creates opportunities to add value through new dollars or portfolio restructuring. Staying invested and informed can position investors to benefit when the technical pressure subsides.

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