MacKay Municipal Managers™

2025 Taxable Municipal Themes

MARCH 2025

Employ Security Selection and Tactical Trading to Drive Performance

In our view, demand for taxable municipals will remain elevated as absolute yields and solid credit fundamentals provide a haven during a period of global economic uncertainty. 2025 will be an exciting year in the municipal marketplace given the new incoming administration's desire to extend the 2017 Tax Cuts and their struggle to find ways to finance payfors. While tariffs have been mentioned as one key financing source, other sources may prove to be elusive. Choosing among which discretionary federal budget items to cut or decrease will be challenging. Among these items, the cost of tax-exemption has come back under the microscope. Even if, as is our view, the chances are remote of a full repeal of tax-exempt borrowing by State and Local governments, headline risk will be plentiful as other alternative options are discussed. Therefore, capitalizing on relative value trades such as investing in off-the-run securities, exploring different coupon structures, and looking at opportunities in tax-exempt securities when valuations are compelling we believe will reward investors in the taxable municipal marketplace.

1 PAY ATTENTION TO BOND STRUCTURE	Deeply discounted structures, vestiges of a low-interest rate world in the late 20 teens to early 2020's, will be in high demand as long term investors seek distressed-like prices and par/premium bonds become more the norm.
2 BELLY CAN DRIVE RETURNS	**Take a more defensive/intermediate posture:** As we enter 2025, we believe investor positioning across markets may be too optimistic. With a backdrop of multi-decade tight credit spreads, the breakeven spread (how much a bond's spread must widen before generating negative excess returns) in the 30-year point is relatively tight, but wider in the 5-10 yr portion of the curve[1]. Investors should be rewarded by defensive curve positioning in the belly of the curve.
3 QUALITY UP	Credit spreads are tight, and we expect this trend to continue into 2025. In addition, across the credit risk spectrum, investors reached for yield during 2024, and lower rated credits have tightened more than their higher rated counterparts, decreasing the spread between ratings categories. We think fixed income markets have grown complacent with the numerous political and economic risks looming on the horizon. As such, we think the spread compression is overdone and has tilted the risk/reward framework towards moving out of lower rated credits into higher rated ones.

[1] Source: Bloomberg, as of February 3, 2025

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