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## JEFFREY BURGER FOCUS ON US MUNICIPAL BONDS

Senior portfolio manager Jeffrey Burger answers questions on Insight's outlook for us municipal bonds, the team's favoured sectors and which parts of the municipal bonds market we believe are less attractive.

### **WHAT ARE US MUNICIPAL BONDS AND HOW ARE THEY ISSUED?**

US municipal bonds are debt securities issued by US state and local governments, as well as non-profit entities, to fund public infrastructure projects. These projects can include water systems, bridges, airports, and hospitals. Municipal bonds can be issued in two main forms: general obligation (GO) bonds and revenue bonds. GO bonds are funded through tax revenues, while revenue bonds are secured by income generated from specific local infrastructure assets.

### **WHY DO YOU PREFER MUNICIPAL REVENUE BONDS OVER GENERAL OBLIGATION BONDS?**

We favour municipal revenue bonds due to their strong credit fundamentals, greater insulation from political risk, and historically attractive yields. These bonds are better insulated from economic slowdowns compared to tax-reliant general obligation municipal bonds. Revenue bonds are secured by income generated from specific local infrastructure assets, making them a more stable and reliable source of bond income.

### **WHICH PARTS OF THE MUNICIPAL BOND MARKET ARE YOU CURRENTLY FAVOURING?**

From a sector perspective we are maintaining a bias toward overweighting essential service revenue bonds (water/sewer, electric utilities). These offer attractive yields and solid fundamental credit profiles. By contrast, state and local general obligation issues are backed by more cyclical sources of tax revenues which could soften in an economic downturn.

In the near term, we think positioning with a slightly long duration bias versus benchmarks should allow portfolios to benefit from a technical backdrop characterised by limited supply and heavy reinvestment flows. The recent steepening of the municipal yield curve has incentivised some investors to extend duration and capture attractive incremental yield in the face of some easing from the Federal Reserve. The prospect of higher inflationary impacts from the fiscal and tariff policy of the new administration may drive a more bearish steepening environment longer term as long rates could be pressured higher.

On balance, we prefer to focus on large, geographically diversified issuers with strong balance sheets, which are able to withstand temporary periods of economic weakness. We continue to see good value in airport and toll road credits due to the recovery of air and vehicular travel to pre-pandemic levels. We also continue to search for idiosyncratic buying opportunities across all sectors as well as quality ranges.

### **WHICH SECTORS ARE YOU FAVOURING LESS?**

In our view, several sectors appear less desirable than those already mentioned. For example, we believe mass transit remains challenged due to work-from-home arrangements, although we are seeing some momentum toward returning to office. Healthcare is facing headwinds from rising labour and equipment costs, while higher education is strained by weakening demographic trends and tuition affordability concerns.

### **HOW ARE YOU ASSESSING THE CREDIT QUALITY OF THE MUNICIPAL BOND MARKET?**

Overall, the credit quality of the market remains resilient. This resilience is reflected in the percentage of upgrades continuing to far exceed downgrades. According to the latest available data, the ratio of upgrades to downgrades for Q4 was almost three to one. We believe the persistent positive rating actions reflect continued economic stability and strengthening of finances for municipal bond issuers. In addition, credit conditions are supported by very high reserves and cash balances

### **WHAT IS YOUR OUTLOOK FOR MUNIS IN 2025?**

We think the US economy will exhibit resilience, moderating inflation, which coupled with the Fed's continued easing policy, could lead to lower Treasury rates among short to intermediate maturities. Post election, the heightened uncertainty surrounding the new Trump administration's policies of which may be inflationary is likely to keep pressure on longer maturity rates. Municipal yields should follow the trend in Treasuries with the prospect of more yield-curve steepening.

## IMPORTANT INFORMATION

### RISK DISCLOSURES

**Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.**

Any projections or forecasts contained herein are based upon certain assumptions considered reasonable. Projections are speculative in nature and some or all of the assumptions underlying the projections may not materialise or vary significantly from the actual results. Accordingly, the projections are only an estimate.

Portfolio holdings are subject to change, for information only and are not investment recommendations.

### ASSOCIATED INVESTMENT RISKS

#### Fixed income

- Investments in bonds are affected by interest rates and inflation trends which may affect the value of the portfolio.
- A credit default swap (CDS) provides a measure of protection against defaults of debt issuers but there is no assurance their use will be effective or will have the desired result.
- The issuer of a debt security may not pay income or repay capital to the bondholder when due. The return risk to a portfolio is higher where a portfolio is highly concentrated in such an issuer.
- Derivatives may be used to generate returns as well as to reduce costs and/or the overall risk of the portfolio. Using derivatives can involve a higher level of risk. A small movement in the price of an underlying investment may result in a disproportionately large movement in the price of the derivative investment.
- Investments in emerging markets can be less liquid and riskier than more developed markets and difficulties in accounting, dealing, settlement and custody may arise.
- Where high yield instruments are held, their low credit rating indicates a greater risk of default, which would affect the value of the portfolio.
- The investment manager may invest in instruments which can be difficult to sell when markets are stressed.
- Leveraged funds: as a result of market conditions, the value of the assets held by a Fund may fall and result in a higher degree of leverage than is deemed appropriate by the Investment Manager. In order to reduce the degree of leverage, the Investment Manager may seek to reduce a Funds' total asset exposure. Investors would need to subscribe for additional Shares in order to maintain the level of sensitivity to market movements. Where such an event is unanticipated, this may result in the investors having less sensitivity to market movements than they might consider appropriate to their individual requirements until they have subscribed for additional Shares.

### FIND OUT MORE

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