

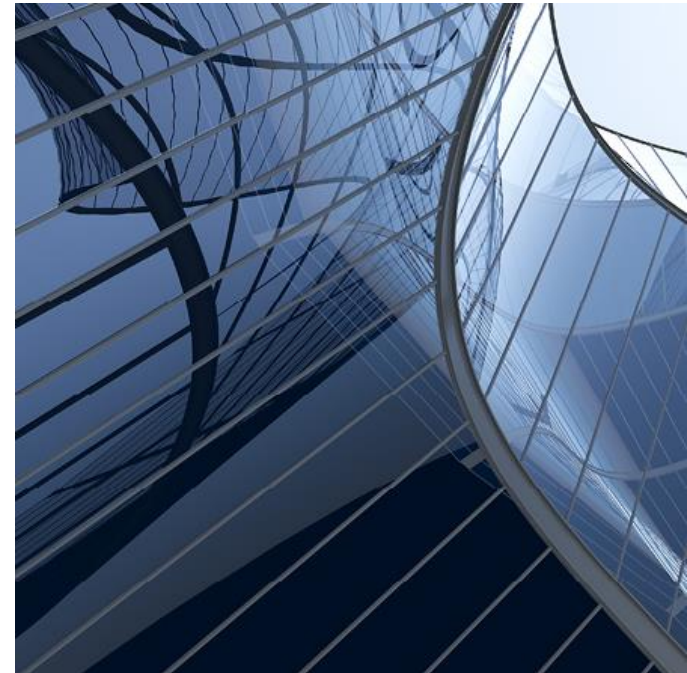
Morgan Stanley

INVESTMENT MANAGEMENT

Municipal Bond Market Monitor

Municipal Bond Group

Q3 2024



Q3 2024 Municipal Market Review

Improving Inflationary Data and Beginning of Fed Rate Cutting Cycle Results in Strong Performance

- Muni bond Index: 2.71% | HY Muni Index: +3.21% | Taxable Muni Index: 5.42%
- US Treasury: 4.74% | Corporate: 5.84%

Yields Rally in Q2, But Still Mostly Higher Year-to-Date

Q3 '24 AAA Muni

- 2-Year: 3.11% → 2.30% -81 bps
- 5-Year 2.89% → 2.31% -58 bps
- 10-Year 2.84% → 2.60% -24 bps
- 30-Year 3.72% → 3.52% -20 bps

YTD '24 AAA Muni

- 2-Year: 2.52% → 2.30% -22 bps
- 5-Year 2.28% → 2.31% +3 bps
- 10-Year 2.28% → 2.60% +32 bps
- 30-Year 3.42% → 3.52% +10 bps

Municipal Fund Flows Strongly Positive

- YTD municipal fund flows are up to \$25 billion.
- Long Duration (+\$26.6bn) and High Yield (+\$12.5bn) flows are particularly strong, while Short Term flows (-\$4.8bn) remain negative.

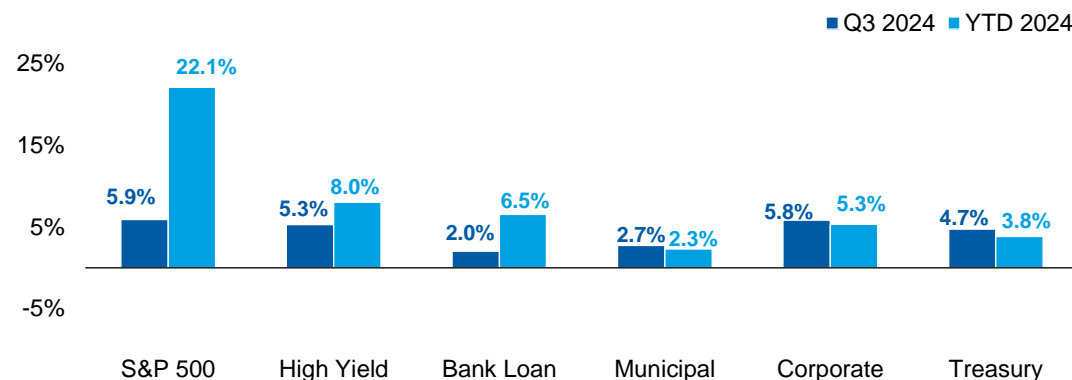
Past performance is no guarantee of future results. It is not possible to invest directly in an index. See end of report for important additional information. This commentary may contain statements that are not historical facts, referred to as "forward looking statements". Actual future results may differ significantly from those stated in any forward-looking statement, depending on factors such as changes in securities or financial markets or general economic conditions.

Source: Index Performance: Bloomberg, AAA YTD changes as of 9/30/2024. Fund Flows: J.P Morgan, Ratios: Bloomberg

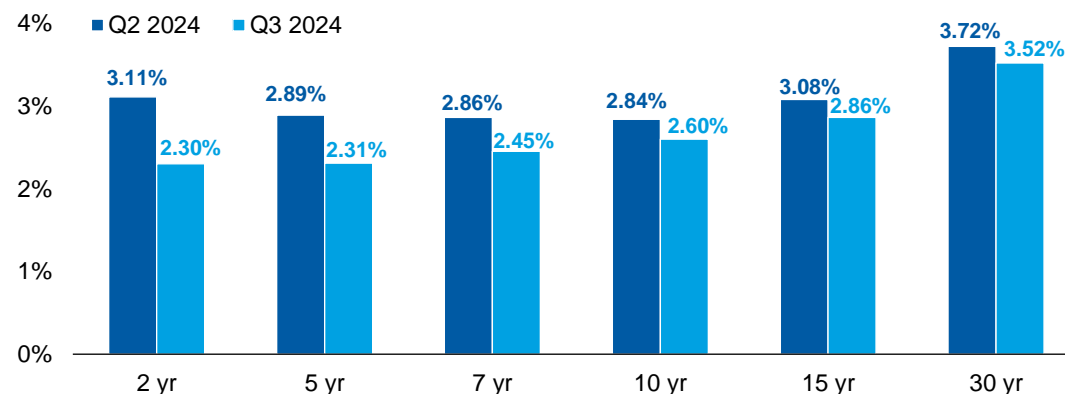
Overview

- After holding Fed funds at 5.25% to 5.5% for over a year, the Fed kicked off the cutting cycle, lowering the policy rate by 50bps on September 18th.
- Chair Powell noted that it was time to recalibrate policy as inflation risks have decreased while risks to the labor market have risen.
- Powell commented that the larger cut was not an indication of the Fed being "behind the curve," but rather a commitment to securing a soft landing.
- Fed projections indicate an additional 50bp of cuts in 2024, 100bp of cuts in 2025, and 50bp of cuts in 2026.
- Treasuries rallied aggressively during the quarter with 2-year, 10-year and 30-year yields 108 bps, 58 bps and 41 bps lower, respectively.
- Municipals rallied to a lesser degree with 2-year, 10-year and 30-year yields 81 bps, 24 bps and 20 bps lower, respectively.
- Even with the Q3 rally, 10-year AAA municipal yields are still 29 bps higher for the year.

Major Asset Class Returns



AAA Municipal Yields (%)

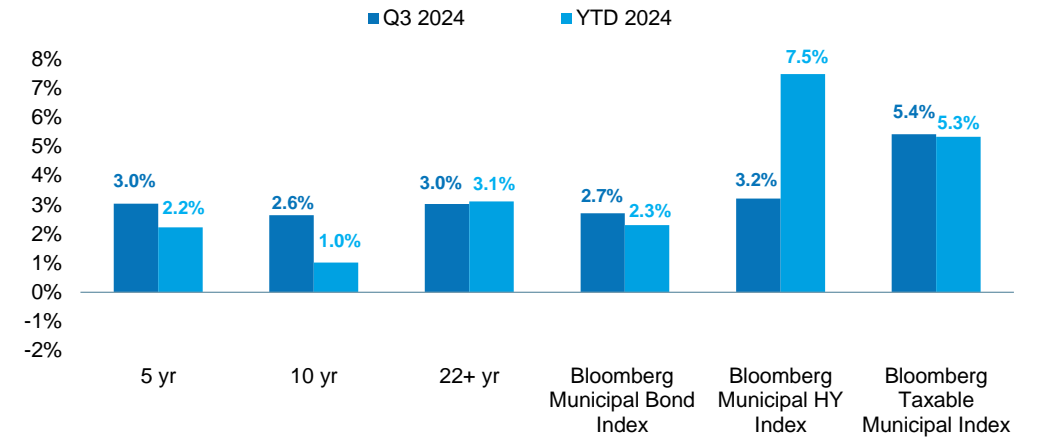


Source: Bloomberg and Morningstar Direct as of 9/30/24. **Past performance is no guarantee of future results.** It is not possible to invest directly in an index. See end of report for important additional information. *Basis points (BPS) is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument.

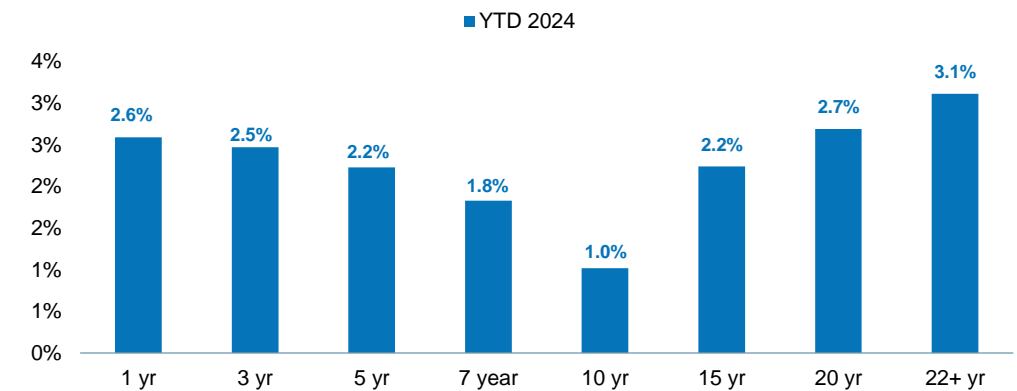
Index Returns

- Q3 performance was strong across the municipal curve and credit spectrum.
- High yield municipals continued to outpace investment grade returning 3.2% for the quarter and 7.5% year-to-date.
- Year-to-date, performance has been strongest at the very short end and the very long end of the municipal curve.
- Barbell curve positioning has outperformed this year and should continue to be beneficial in the early stages of the rate cutting cycle.

Tax-Exempt and Taxable Index Returns



Investment Grade Tax-Exempt Index Returns

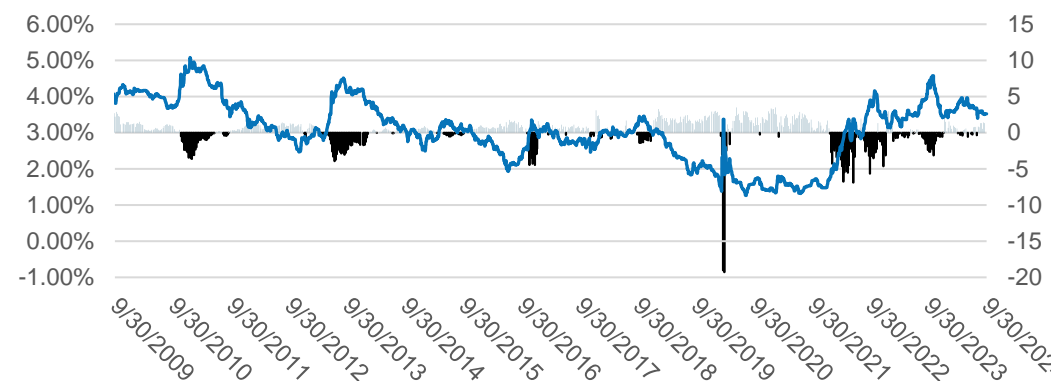


Source: Bloomberg, MMA and Morningstar Direct as of 9/30/24. **Past performance is no guarantee of future results.** Performance less than one year is cumulative. It is not possible to invest directly in an index. See end of report for important additional information.

Municipal Fund Flows

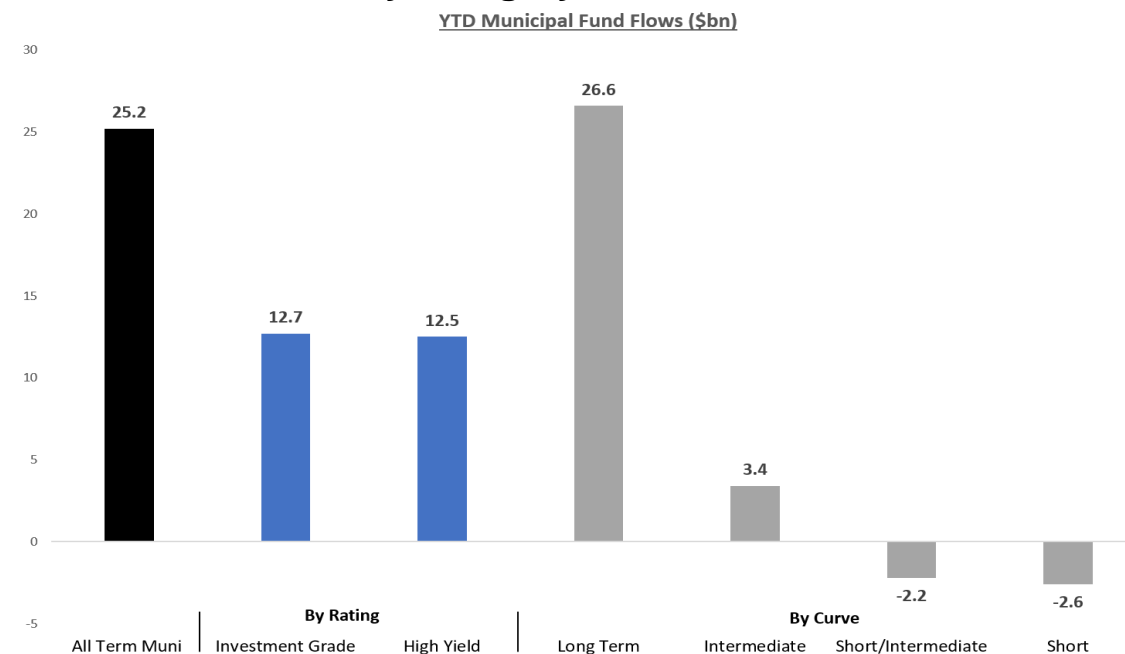
- Municipal fund flows were positive every week in Q3 bringing YTD fund inflows to ~\$25bn. Of the total, ~\$17.6bn has entered open-end funds while ETFs have received ~\$7.6bn.
- Given the expectation for additional rate cuts in Q4 and beyond, we anticipate fund flow momentum to persist in coming months.

Muni Mutual Fund Flows



- By duration, long-term funds have posted the highest inflows, while short/intermediate and short-term funds show outflows.
- By credit quality, both investment grade and high yield funds have posted significant inflows.

Muni Fund Flows By Category

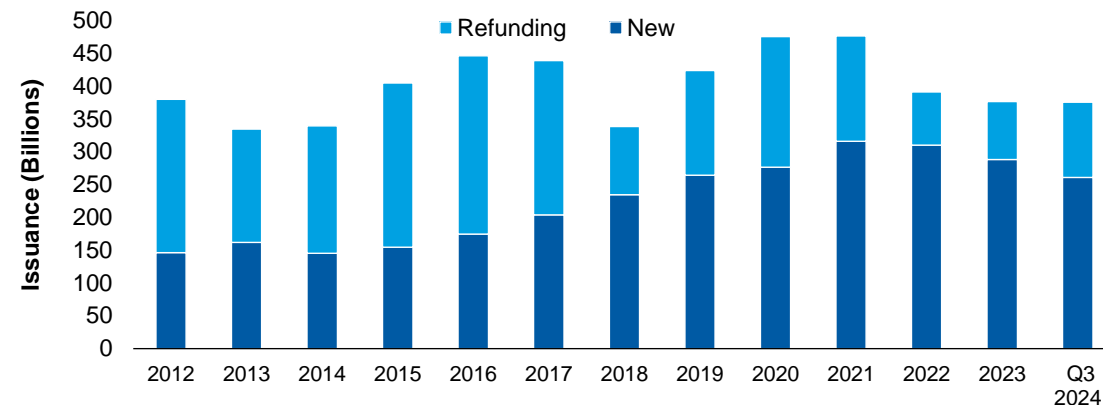


Source: Thomson Reuters Municipal Market Data. Date Range: September 2009– September 2024. Flow data provided by J.P. Morgan as of 9/25/2024.

Municipal Issuance

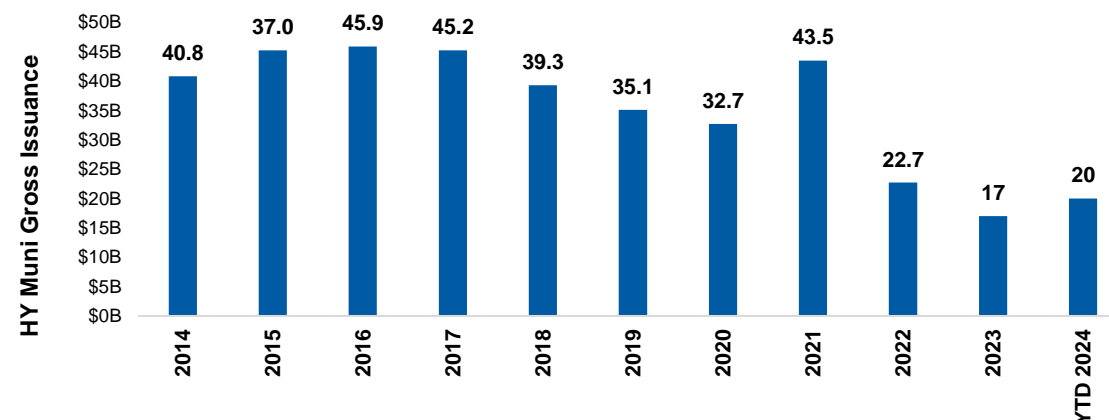
- At \$375bn, year-to-date issuance is up 32% year-over-year. Approximately 70% of issuance is new money and 30% refunding deals.
- We anticipate elevated issuance in October; however, consistent with 2016 and 2020 elections, we expect November/December issuance to decline meaningfully.

Municipal Bond Issuance: New vs. Refunding



- At \$20bn, high yield municipal issuance is down significantly relative to its historical average of ~\$40bn per year.
- Elevated yields, reduced high yield issuance and strong high yield fund flows provide technical support for continued outperformance in Q4.

Municipal Bond Issuance: High Yield

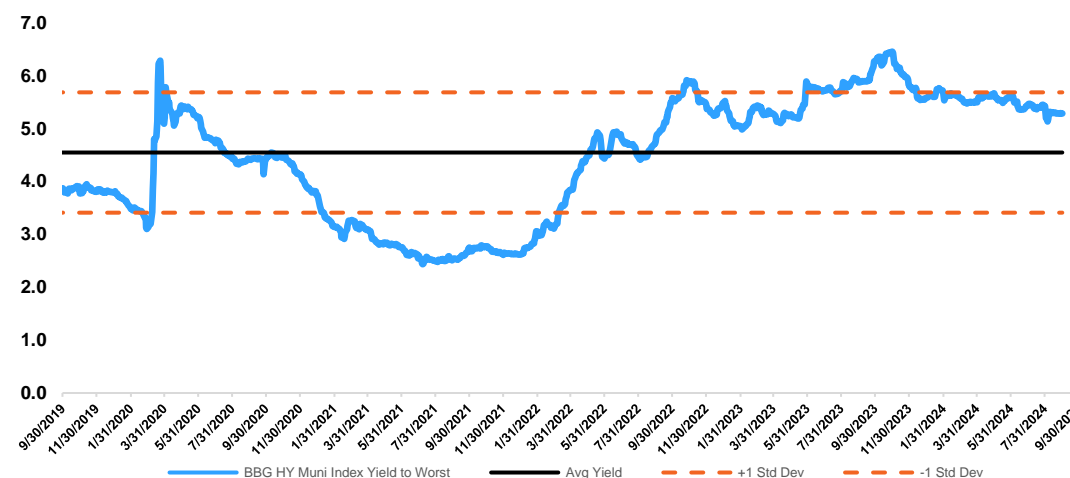


Source: Municipal Bond Issuance data from Bloomberg Barclays Research and J.P. Morgan as of 9/30/2024. Private placement issuance counted as new capital.

High Yield Municipals

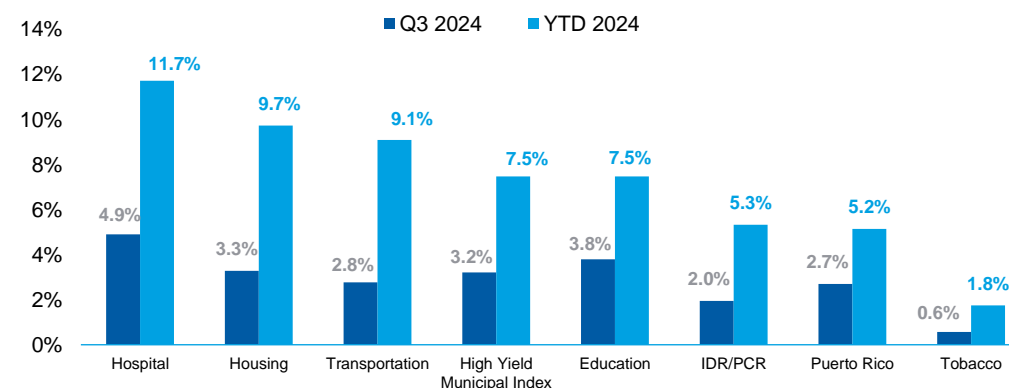
- The yield-to-worst on the High Yield Municipal Index declined 23bps during the quarter from 5.43% to 5.20%.
- At 5.20%, yields remain attractive and are still almost one standard deviation wide to the Index's 5-year average of 4.75%.

High Yield Municipal Index YTW



- Hospital, Housing, and Transportation have been top performing sectors in the High Yield Municipal Index on a year-to-date basis.
- Despite being one of the most liquid areas of the high yield market, the tobacco sector has underperformed materially due to declining MSA payments.

High Yield Municipal Sector Returns

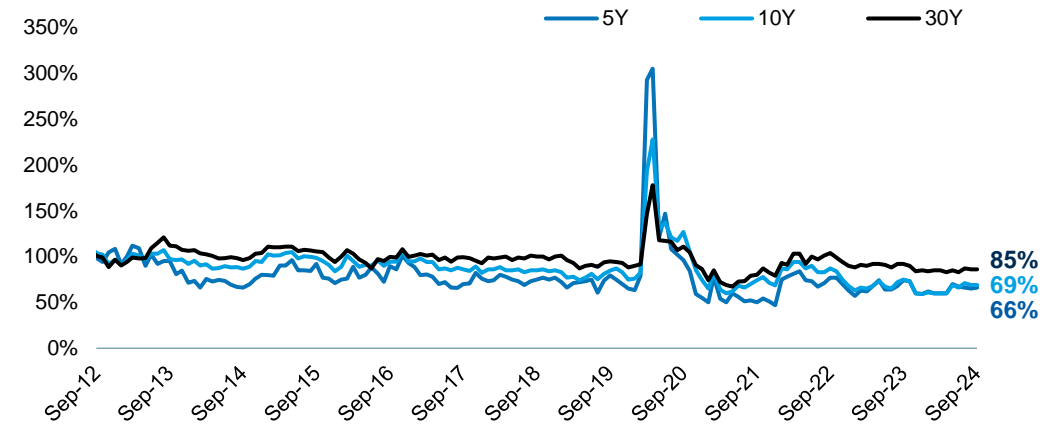


Source: Bloomberg Barclays Research. The index performance is provided for illustrative purposes only and is not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.**

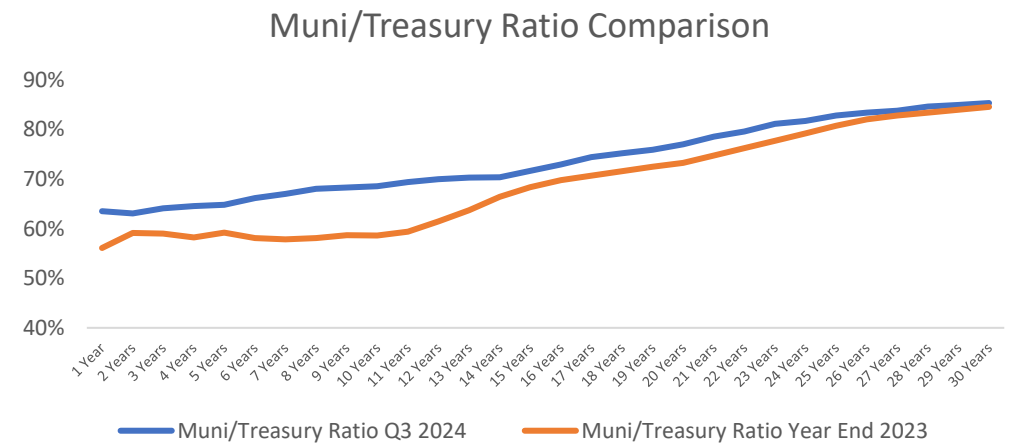
Muni-to-Treasury Yield Ratios

- Short term muni-to-treasury ratios richened slightly in Q3, while longer term ratios cheapened.
- Specifically, the 5-year muni/treasury ratio decreased from 67% to 66%, while the 10-year increased from 66% to 69% and the 30-year increased from 83% to 85%.
- Year-to-date, Muni/Treasury ratios have cheapened meaningfully with the 8yr, 9yr, and 10yr easing the most.
- Even with the YTD cheapening, investors may benefit from moving down in quality for attractive value and should consider active strategies focused on income and total return.

AAA Muni-to-Treasury Yield Ratios (%)



Muni/Treasury Ratios YTD



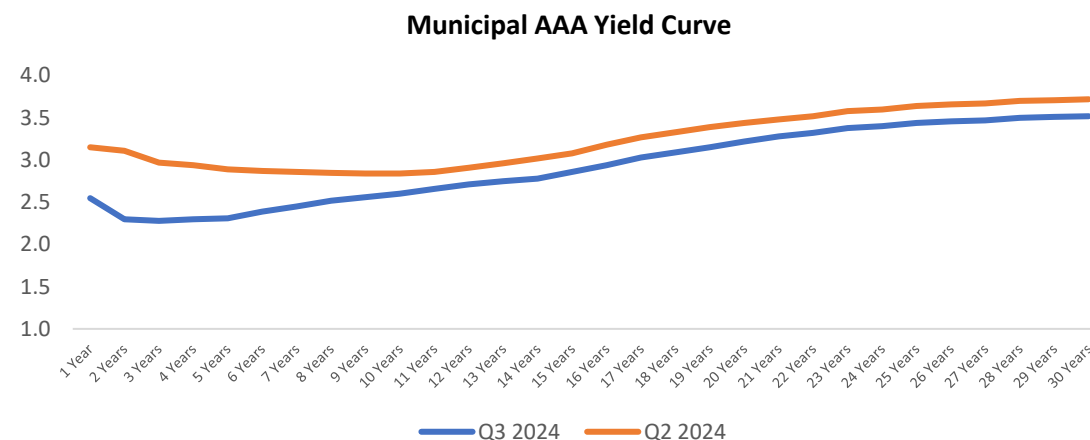
Source: Thomson Reuters as of 9/30/24, Bloomberg as of 9/30/24. **Past performance is no guarantee of future results.** See end of report for important additional information.

Municipal Yield Curve

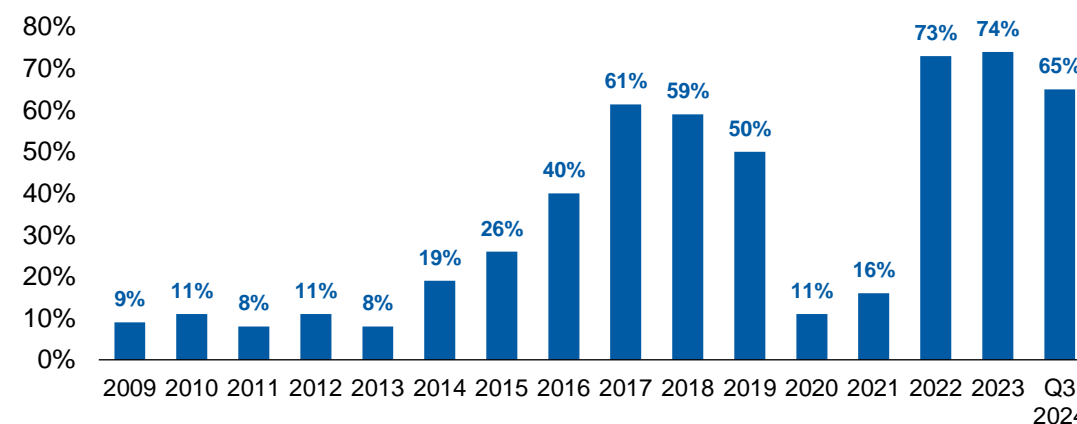
- The municipal curve steepened materially in Q3 as 2-year yields decreased 81bps, and 30yr yields decreased 4bps.
- The treasury curve steepened in a similar fashion as the 2-year yield fell 108 bps while the 30-year yield declined 40bps.

- With the Q3 steepening, the 2-year municipal now captures 65% of the 30yr yield compared to 74% at the beginning of the year.
- Short-term municipal yields remain attractive particularly compared to taxable alternatives. We believe investors should consider a barbelled approach by adding duration and locking in longer-term yields.

AAA Muni Yield Curve Comparison



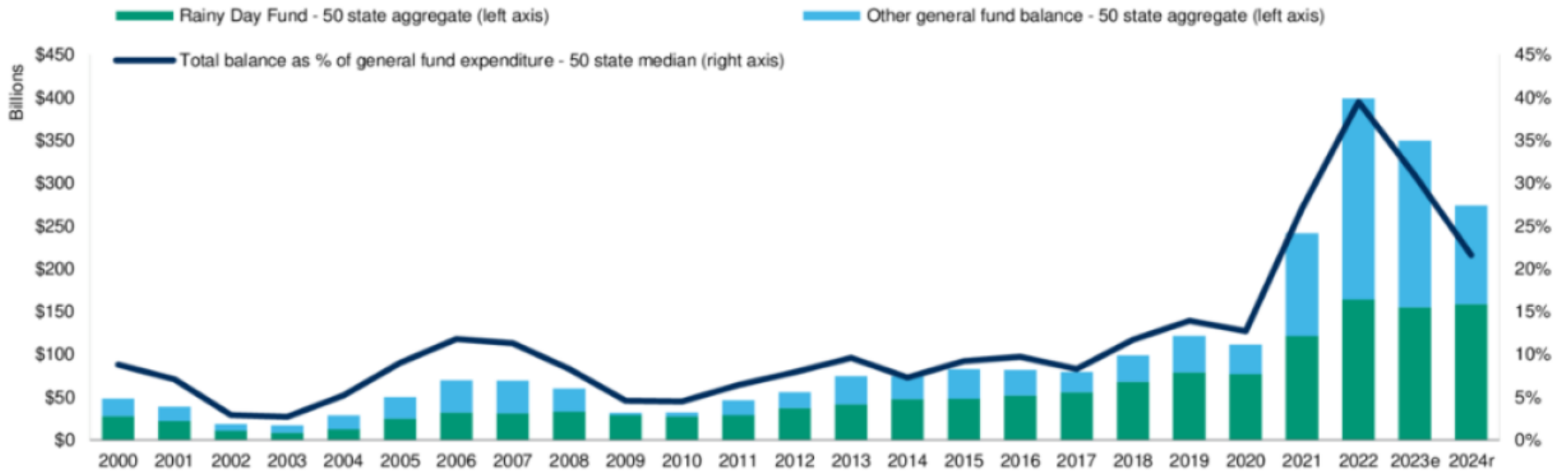
% of Municipal Curve Captured by 2-Yr Municipal Bond



Source: Thomson Reuters as of 9/30/24, Bloomberg as of 9/30/24. **Past performance is no guarantee of future results.** See end of report for important additional information.

States Outlook is Stable, with Strong Fiscal Management Offsetting Slow Revenue Gains

Median rainy day fund balances and reserves will come down from all-time high, but states continue with structural budgetary balance

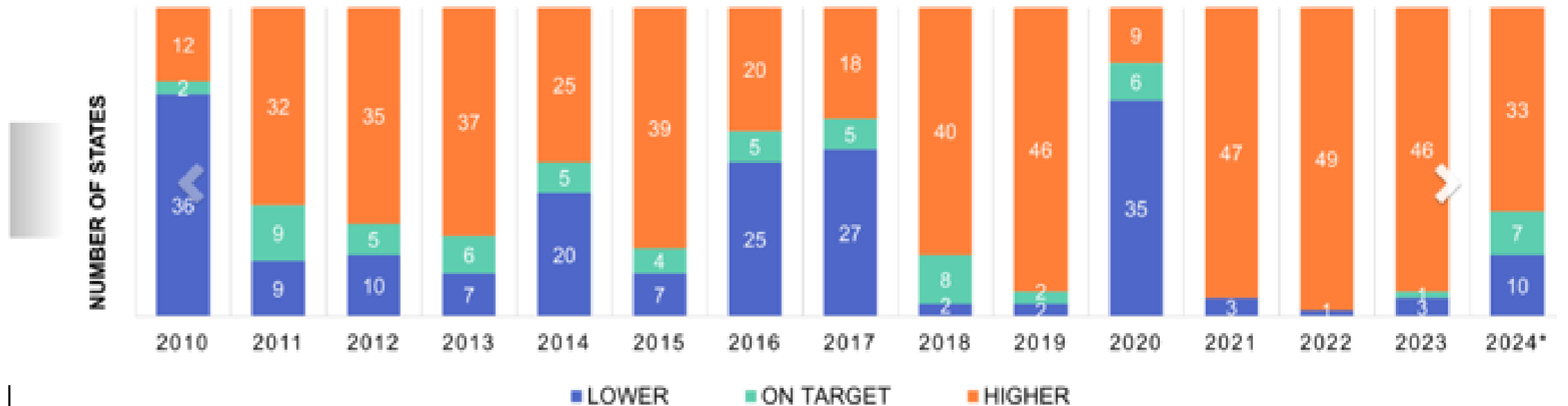


Source: National Association of State Budget Officers, Moody's Ratings

States Revenue High than Forecasts

Despite slowing growth in revenue, the majority of state reported collections exceeded original estimates for FY24

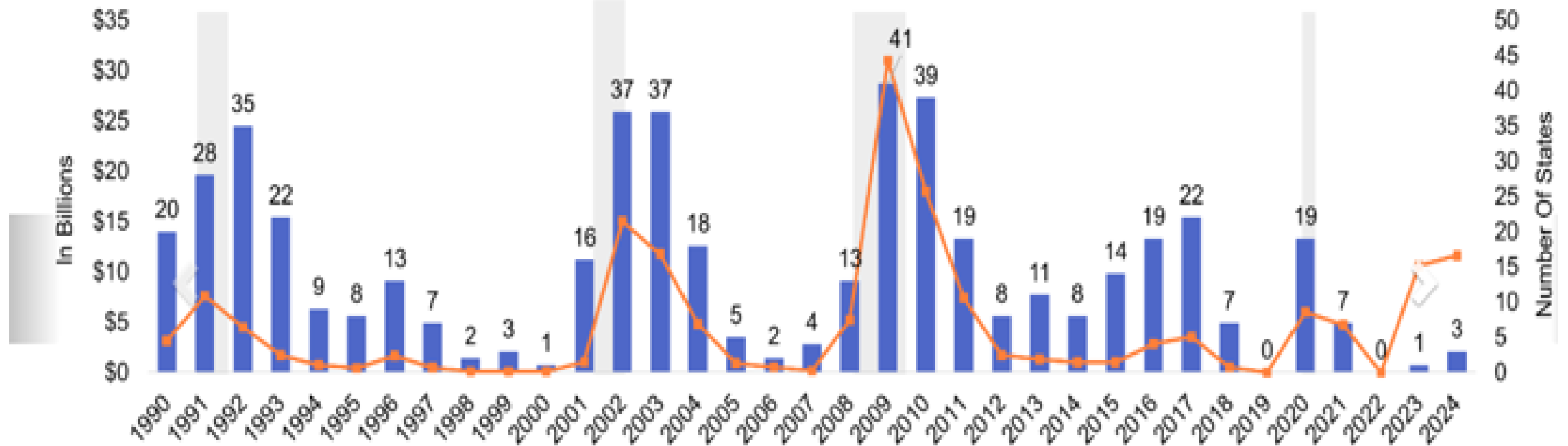
General Fund Revenue Collections Compared To Original Revenue Projections (By Fiscal Year)



Source: National Association of Budget Officers.

Mid-Year Budget Reductions Due to Shortfalls Continue to be Infrequent

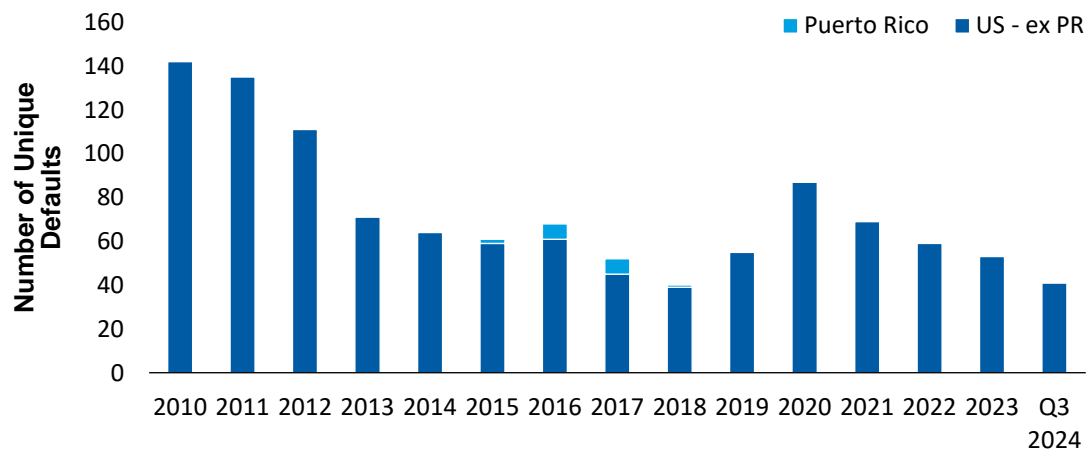
Budget Cuts Made After The Budget Passed Due to a Revenue Shortfall



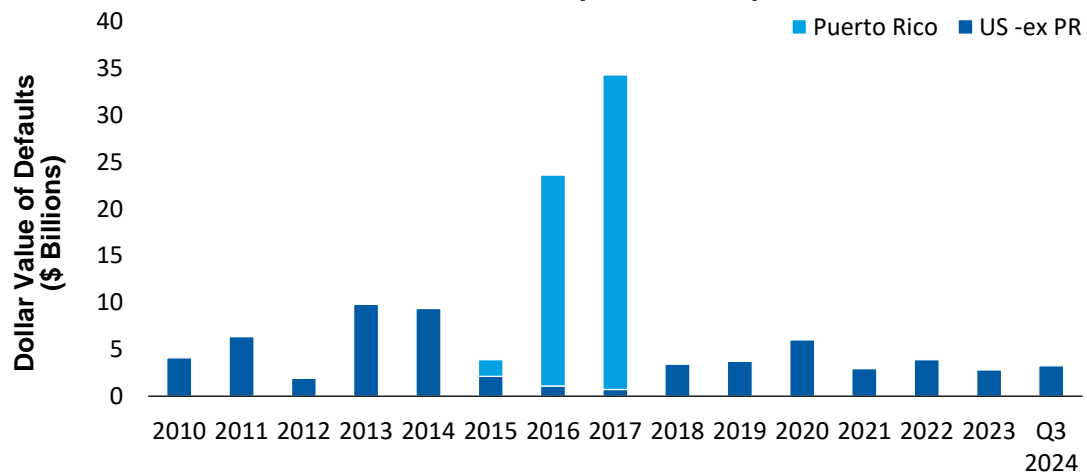
Source: National Association of Budget Officers.

Municipal Default Overview

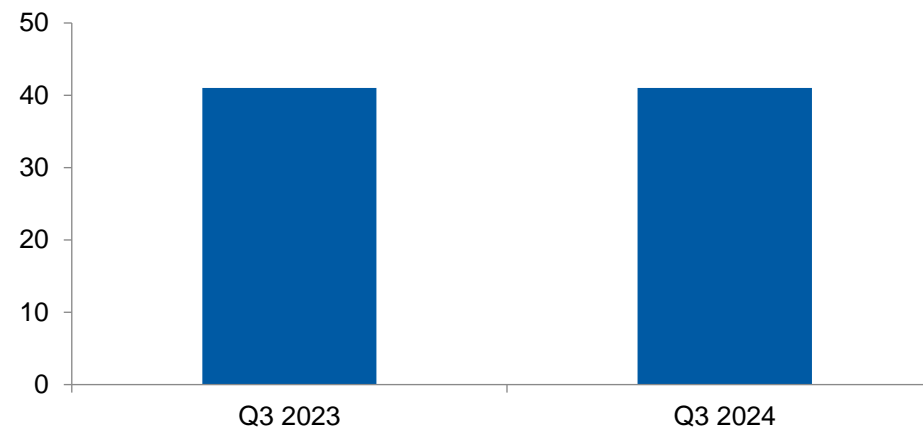
Number of Unique Annual Defaults



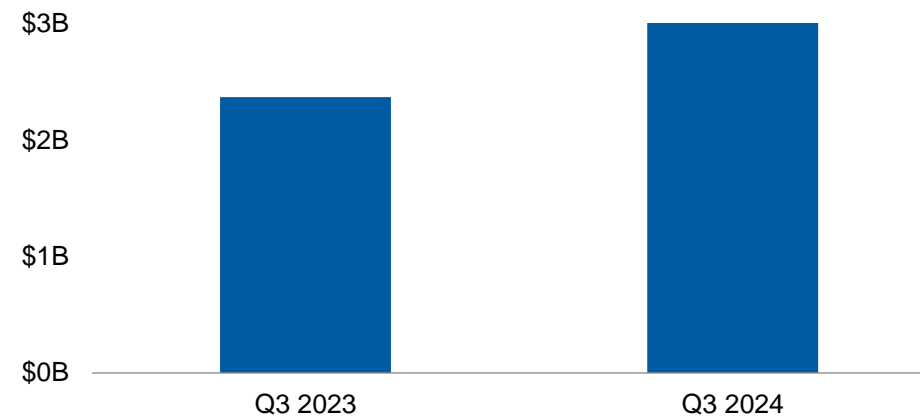
Dollar Value of Annual Defaults (\$ Billions)



YTD Number of Unique Defaults was flat YoY



YTD Dollar Value of Defaults (\$ Billions) Increased by 37%

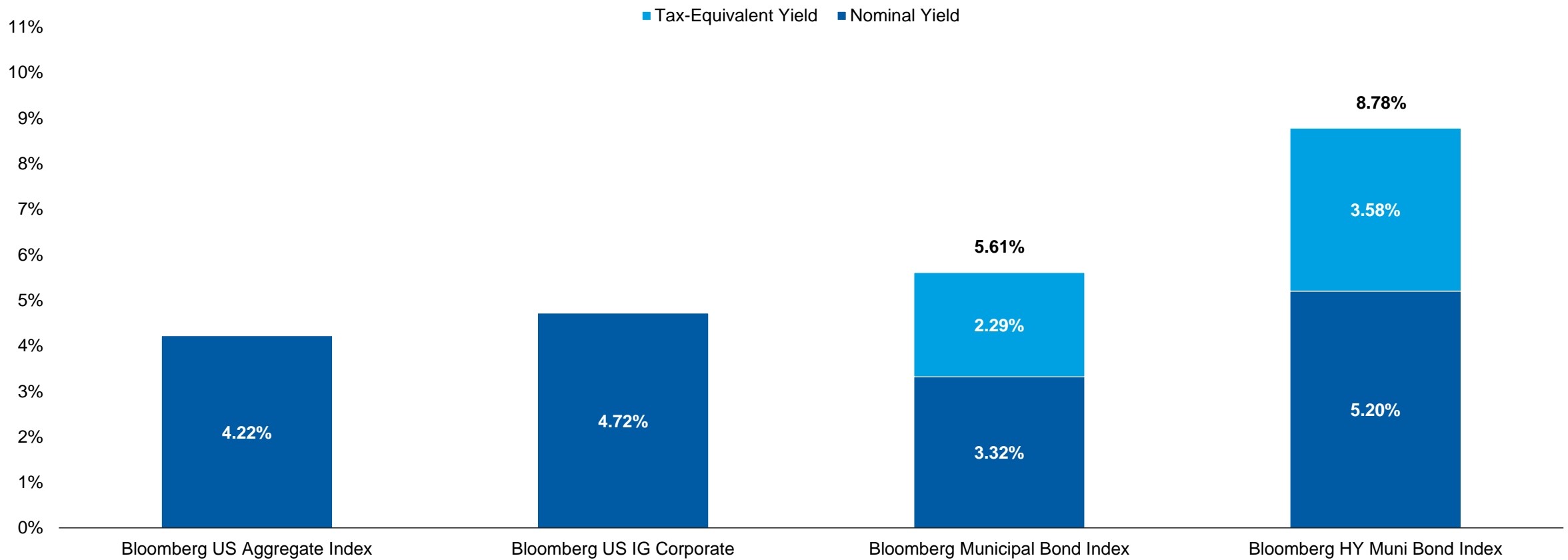


Source: MMA. Default data as of 9/30/2024

Taxable Equivalent Yields

Municipal taxable-equivalent yields appear very attractive relative to other high quality options.

Taxable Equivalent Yields



Sources: Barclays Live as of 9/30/24, Tax Policy Center. This table is for illustrative purposes only and uses the highest current applicable federal tax rates plus 3.8% health care tax. **Past performance is no guarantee of future results.** It is not possible to invest directly in an index. See end of report for important additional information.

Municipal Market Outlook

- Though September Fed projections indicated an additional 50bp of cuts in '24, we remain highly focused on upcoming employment data and whether a soft landing can be achieved.
- Even with the Q3 strength, intermediate to long municipal yields are still 10-30bp higher for the year, providing investors with more time to add duration ahead of additional Fed cuts.
- Given the expectation for additional rate cuts in Q4 and beyond, we anticipate a continuation of net positive flows to the asset class in Q4.
- Barbell curve positioning has outperformed this year and should continue to be beneficial in the early stages of the rate cutting cycle.
- With the election approaching and most individual tax cuts set to expire at the end of 2025, we remain focused on proposed legislation related to changes to marginal tax rates, the standard deduction, the cap on State and Local Tax deductions (SALT) and the phaseout of the Alternative Minimum Tax (AMT) exemption.
- Bottom line: While the timing and pace of additional rate cuts remain data dependent, we encourage investors to consider stepping out of cash, assume more credit and duration risk, and lock in yields near decade highs.

Appendix: Additional Slides

Overview of Legislation and Municipal-Related Spending in Relief Bills

The below table provides a high-level summary of the fiscal support for municipals through the four most recent pieces of legislation passed by Congress. In aggregate, over \$1.7 trillion of capital has been allocated to various parts of the municipal bond market.

	2021 Infrastructure Bill	American Rescue Plan	Dec. Federal Stimulus	CARES Act
Total Muni Market Support	\$550	\$650	\$157	\$347
States	\$136	\$408	\$30	\$169
Locals	--	\$182	\$30	\$164
Community based orgs.	--	–	–	\$1
Not for Profits	--	\$0.8	\$15	–
Healthcare	--	\$13	\$4	\$108
Primary/Sec Education	--	\$137	\$58	\$25
Higher education	--	\$40	\$26	\$17
Airports/Ports	\$42	\$11	\$2	\$10
Surface transit	\$110	–	\$10	–
Mass transit	\$39	\$30	\$14	\$25
Other Transportation	\$78	\$2	\$2	–
Housing	--	\$39	\$25	–
Utilities	\$143	–	–	–

Source: US Congress, J.P Morgan. Note: Sum of individual sector amounts may not add up to aggregate total due to double counting, as much of the capital is shared across sectors.

RISK CONSIDERATIONS

An imbalance in supply and demand in the municipal market may result in valuation uncertainties and greater volatility, less liquidity, widening credit spreads and a lack of price transparency in the market. There generally is limited public information about municipal issuers. Investments in income securities may be affected by changes in the credit worthiness of the issuer and are subject to the risk of non-payment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer's ability to make principal and interest payments. As interest rates rise, the value of certain income investments is likely to decline. The London Interbank Offered Rate or LIBOR, is used throughout global banking and financial industries to determine interest rates for a variety of financial instruments (such as debt instruments and derivatives) and borrowing arrangements. The ICE Benchmark Administration Limited, the administrator of LIBOR, ceased publishing certain LIBOR settings on December 31, 2021, and is expected to cease publishing the remaining LIBOR settings on June 30, 2023. The transition process may involve, among other things, increased volatility or illiquidity in markets for instruments that currently rely on LIBOR, such as floating-rate debt obligations. Investments involving higher risk do not necessarily mean higher return potential. Diversification cannot ensure a profit or eliminate the risk of loss. Debt securities are subject to risks that the issuer will not meet its payment obligations. Low rated or equivalent unrated debt securities of the type in which a strategy will invest generally offer a higher return than higher rated debt securities, but also are subject to greater risks that the issuer will default. Unrated bonds are generally regarded as being speculative.

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ADDITIONAL INFORMATION

Important Information and Disclosure

TERMS

Municipal-to-Treasury Yield Ratios are relative value indicators that measure the richness or cheapness of Municipal bond yields to comparable maturity Treasury bond yields.

Yield to Worst is a measure which reflects the lowest potential yield earned on a bond without the issuer defaulting. The yield to worst is calculated by making worst-case scenario assumptions by calculating the returns that would be received if provisions, including prepayment, call or sinking fund, are used by the issuer.

INDEX DEFINITIONS

Bloomberg Municipal Bond Index is an unmanaged index of municipal bonds traded in the U.S.

Bloomberg High Yield Municipal Bond Index is an unmanaged index of non-Investment Grade Municipal bonds traded in the U.S.

Bloomberg Taxable Municipal Bond Index is an unmanaged index of Taxable Municipal Bonds traded in the U.S.

Bloomberg U.S. Treasury Index measures public debt instruments issued by the U.S. Treasury.

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MIDDLE EAST

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