PGIM FIXED INCOME

Q1 2025 Municipal Bonds Outlook

Transcript

[Music]

Jason Appleson, CFA, FRM, Head of Municipal Bonds: Municipal bonds finished 2024 with a modestly positive return. Municipal returns were a function of tightening spreads, offset by rising rates. Other key themes in 2024 included: positive inflows, higher new issue supply, elevated appetite for credit risk, and a recalibration of the Fed's easing cycle. As we look to 2025, we take a more mixed view of the markets. On the one hand, all-in yields continue to hover near decade highs. On the other hand, valuations, both on a credit spread basis and a taxable-equivalent basis are signaling rich relative to historical levels. Further, we believe trends in higher supply will continue into 2025, especially if Congress debates limiting the type of issuers that can use the tax exemption. Higher supply could add pressure to the markets, especially as the amount of bonds maturing and called level off at the end of the first quarter. Fund flows will be a key determinant of performance this year. Our economics team continue to see the economy move toward a moderate growth scenario, which could keep interest rates relatively range-bound. If retail customers view the economy favorably and the Fed continues to reduce rates towards its terminal level, we believe fund flows could remain resilient, especially as many financial advisors look to move their clients into longer-duration strategies. To summarize, we like the slope and carry that the 15- to 20-year portion of muni curve offer but we think spread durations should be limited as a result of rich valuations. With a moderate growth backdrop, we think fundamentals in real estate and segments of healthcare continue to provide attractive buying opportunities. While we expect countervailing forces in the market in 2025, we believe the municipal market still offers opportunities for tax-aware investors.

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Source(s) of data (unless otherwise noted): PGIM Fixed Income, as **January 2025**.

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