

Muni Monthly

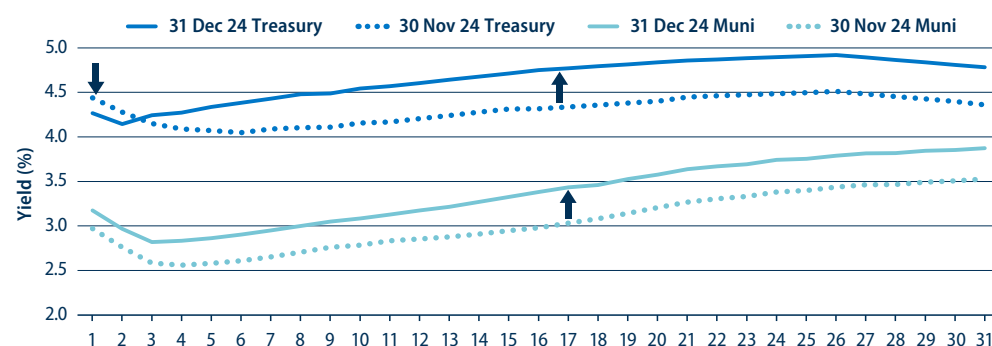
Performance Overview

Muni yields moved higher as the Treasury curve steepened.

Fixed-income generally sold off in December as yields moved higher due to stronger-than-anticipated GDP data, which led market participants to question the path of inflation and interest rates in 2025. The Treasury yield curve steepened, with short maturities moving up to 17 basis points (bps) lower, while longer maturities moved up to 44 bps higher. Muni market yields moved higher across the curve, generally underperforming Treasuries amid the rate volatility and weakening supply and demand technicals.

The Bloomberg Municipal Bond Index returned -1.46% in December. Longer-duration municipals underperformed amid the rate volatility, as did lower investment-grade and high-yield municipals. All told, the Bloomberg Municipal Bond Index closed the year up 1.05%, outperforming Treasuries but underperforming investment-grade credit indices. High-yield municipals posted the strongest returns across the muni market, returning 6.32% during the year. The longer-duration Bloomberg Taxable Municipal Bond Index returned -2.46% in December, leading year-to-date returns to 1.57%, outperforming the Bloomberg US Treasury Index (0.58%) and the Global Aggregate (-1.69%).

Exhibit 1: Municipal and Treasury Yield Curves



Source: Bloomberg. As of 31 Dec 24. AAA Callable Municipal Yield Curve and US On-/Off-the-Run Sovereign Curve.

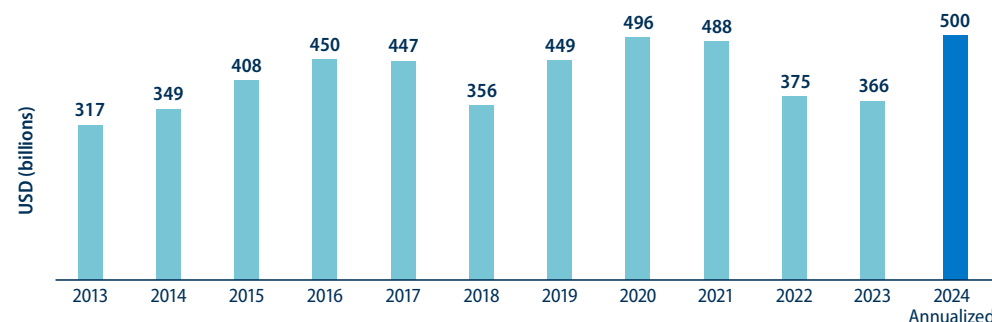
Supply and Demand Technicals

Supply and demand technicals weakened during the month

December new issuance reached \$32 billion, up 26% from November's level, closing out a record supply year of \$500 billion. Tax-exempt supply of \$460 billion comprised 92% of 2024 issuance and was 40% higher year-over-year (YoY), while taxable supply of \$40 billion was just 6% higher than levels of prior years but still below recent averages as issuers sought better opportunities in tax-exempt markets in the higher rate environment.

Municipal demand softened in December as estimates from ICI and Lipper indicated modest net inflows of approximately \$300 million during the month, driven partially by seasonal tax selling pressures. Despite the December demand slowdown, mutual funds recorded \$46 billion of net inflows during the year according to ICI, partially reversing the greater than \$120 billion of outflows recorded over the prior two years.

Exhibit 2: Annual Municipal Issuance



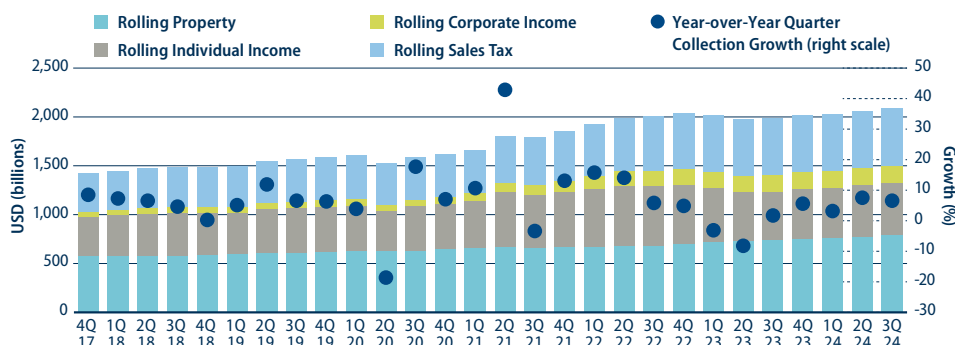
Source: Western Asset, Bloomberg. As of 31 Dec 24.

Fundamentals

State and local revenue collections remain near record levels.

Municipal fundamentals remained resilient in December. The Census released state and local revenue collection estimates which signaled that municipal credit conditions remained well supported by elevated tax collections. Through the third quarter of 2024, 12-month trailing tax collections increased 6.4% YoY to \$2.1 trillion, marking a record high level according to the Census data. On a 12-month trailing basis, individual income tax collections increased 6.6% YoY, corporate income tax collections increased 6.7% YoY, and sales tax collections increased 1.5% YoY. 12-month rolling property tax collections also recorded a strong trend higher, growing 7.7% YoY.

Exhibit 3: 12-Month Trailing State and Local Revenue Collections



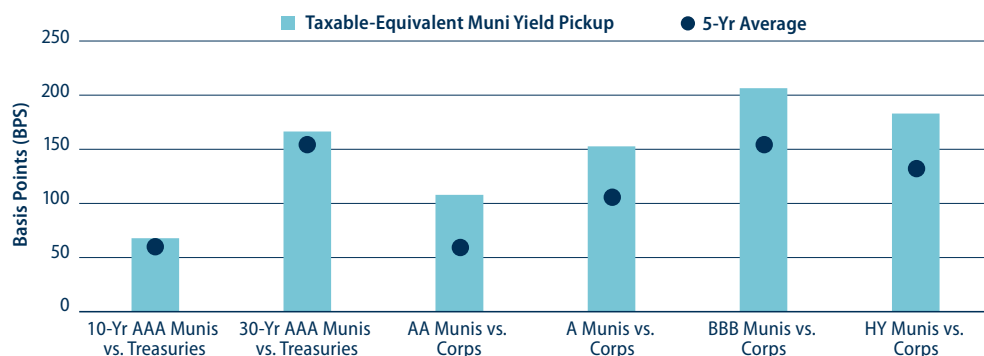
Source: Western Asset, Census NSA major state and local tax revenue. As of 12 Dec 24 (3Q24 data).

Valuations

Municipals currently offer above-average after-tax yield pickup versus taxable counterparts.

December's weakness has contributed to higher income opportunities and improved relative valuations in the municipal market. The Bloomberg Municipal Bond Index average yield-to-worst (YTW) ended the year at 3.74%, up over 50 bps from the start of the year and equivalent to 6.32% on a taxable-equivalent basis. The taxable-equivalent income opportunity, across the curve and credit cohorts, exceeds what is available in taxable fixed-income markets. As the Federal Reserve is expected to continue its rate-cutting cycle into 2025, we expect investors to pursue the relative income opportunities offered by the muni asset class.

Exhibit 4: Taxable-Equivalent Municipal Yield Pickup vs. the Five-Year Average



Source: Bloomberg, Western Asset. 10- and 30-year comparison reflects Bloomberg Valuation Service (BVAL) AAA Muni Curve and US On-/Off-the-Run Sovereign Curve. AA Muni reflects the Bloomberg AA Muni Bond Index. A Muni reflects the Bloomberg A Muni Bond Index. BBB Muni reflects the Bloomberg BBB Muni Bond Index. HY Muni reflects the Bloomberg High Yield Muni Bond Index. AA Corp reflects the Bloomberg AA Corporate Bond Index. A Corp reflects the Bloomberg A Corporate Bond Index. BBB Corp reflects the Bloomberg BBB Corporate Bond Index. Taxable-equivalent yield considers top marginal tax rate of 40.8%. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or a guarantee of future results. As of 31 Dec 24.

Yield-to-Worst (YTW) is the lesser of yield-to-maturity or yield-to-call across all known call dates.

Munis and the Macro¹

	Prior Month (Revised From)	Consensus	Actual
GDP Annualized QoQ (4Q 2024)	3.00%	2.80%	3.10%
CPI YoY	2.60%	2.70%	2.70%
PCE	2.30%	2.50%	2.40%
Unemployment Rate	4.10%	4.10%	4.20%
Change in Nonfarm Payrolls (NFP)	36k (12k)	220k	227k

Yield and Curve Changes - AAA Munis vs. Treasuries³

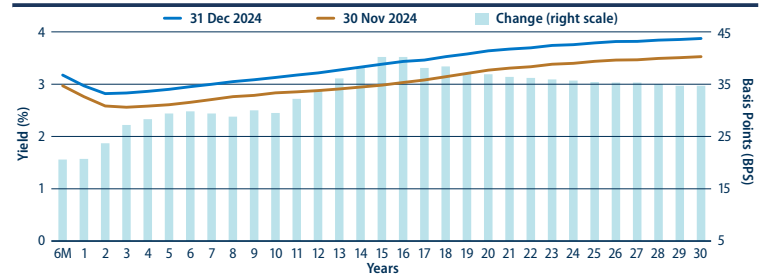
11/29/2024				
	2-Yr	5-Yr	10-Yr	30-Yr
AAA Muni	2.82%	2.87%	3.06%	3.90%
Treasury	4.24%	4.38%	4.57%	4.78%
M/T Ratio	66%	65%	67%	82%
Change				
Muni Δ (bps)	▲ 23	▲ 26	▲ 28	▲ 28
Treasury Δ (bps)	▲ 9	▲ 33	▲ 40	▲ 42
Ratio Δ (%)	▲ 4	▲ 1	▲ 0.3	▼ -1
10-Yr Average				
AAA Muni	1.56%	1.98%	3%	3%
Treasury	2.20%	2.48%	3%	3%
Ratio	71%	80%	94%	94%

After Tax Yield Pickup⁵

Quality/Maturity Segment	Muni YTW	Taxable Equivalent YTW	Taxable YTW	Taxable Equivalent Muni Yield Pickup	5-Yr Average
10-Yr AAA Munis v. Treasuries	3.11%	5.25%	4.57%	68	60
30Y AAA Muni vs Treasury	3.82%	6.45%	4.78%	166	154
AA Munis v. Corps	3.61%	6.09%	5.01%	108	59
A Munis v. Corps	3.99%	6.74%	5.21%	153	106
BBB Munis v. Corps	4.49%	7.58%	5.51%	207	154
HY Munis v Corps	5.52%	9.32%	7.49%	183	133

Municipal Supply⁶

Year	\$B	Month	2023 Issuance	2024 Issuance	YoY	Calls/Maturities	Net
2018	356	January	21.8	31.1	43%	-25.4	5.7
2019	449	February	19.9	31.9	60%	-27.5	4.4
2020	496	March	32.8	37.7	15%	-26.5	11.2
2021	488	April	34.6	45.0	30%	-27.6	17.4
2022	375	May	28.9	47.1	63%	-28.2	18.9
2023	366	June	36.8	47.6	29%	-44.4	3.2
2024 YTD Annualized	500	July	27.3	40.2	47%	-41.0	-0.9
		August	38.2	49.0	28%	-47.7	1.3
		September	28.7	48.9	70%	-24.2	24.7
		October	38.7	64.5	66%	-34.5	30.0
		November	35.6	25.1	-29%	-31.9	-6.8
		December	22.7	31.7	40%	-40.6	-9.0
		Total	366.2	499.9	37%	-399.5	100.4

AAA Municipal Yield Curve²Index Returns⁴

	1-Mo Total Return	YTD Total Return
Bloomberg Municipal Bond Index	-1.46%	1.05%
Returns by Maturity		
Bloomberg Municipal Bond 1-Year Index	-0.02%	2.71%
Bloomberg Municipal Bond 5-Year Index	-0.74%	1.17%
Bloomberg Municipal Bond 10-Year Index	-1.17%	-0.33%
Bloomberg Municipal Bond 20-Year Total Return Index	-2.01%	1.36%
Bloomberg Municipal Bond Long Bond Index	-2.49%	1.40%
Returns by Credit Quality		
Bloomberg Municipal AAA Index	-1.57%	0.33%
Bloomberg Municipal AA Index	-1.36%	0.79%
Bloomberg Municipal A Index	-1.47%	1.78%
Bloomberg Municipal BBB Index	-1.94%	2.87%
Bloomberg Muni High Yield Index	-1.66%	6.32%
Returns by Sector		
GO Bond Index	-1.36%	0.55%
Revenue Bond Index	-1.51%	1.22%
Taxable Muni Returns		
Bloomberg Taxable Municipal Bond Index	-2.46%	1.57%
Bloomberg Global Aggregate Index	-2.15%	-1.69%
Bloomberg U.S. Treasury Index	-1.54%	0.58%
Bloomberg U.S. Corporate Index	-1.94%	2.13%

Demand Technicals - Municipal Mutual Fund Flows⁷

Year	Flows (\$)	2024	Flows (\$)
2018	8,843	January	4,026
2019	102,554	February	2,753
2020	54,468	March	4,087
2021	105,480	April	289
2022	-116,469	May	2,216
2023	-5,695	June	649
2024 YTD	45,640	July	4,885
		August	6,019
		September	6,041
		October	8,677
		November	5,718
		December	280

¹ Source: Bloomberg; GDP, CPI, PCE: BEA; Unemployment, NFP: BLS. As of 31 Dec 24.² Source: Bloomberg, Western Asset. As of 31 Dec 24: Bloomberg Valuation Service (BVAL) AAA Muni Curve and US On-/Off-the-Run Sovereign Curve.³ Source: Muni Yields: Thomson Reuters MMD 2-Year, 5-Year, 10-Year and 30-Year AAA Scales; Treasury Yields: 2-Year, 5-Year, 10-Year, and 30-Year Tenors of the US On/Off The Run Sovereign Curve.⁴ Source: Bloomberg Municipal Bond Index, Bloomberg Taxable Municipal Bond Index. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or a guarantee of future results.⁵ Source: Bloomberg, Western Asset. As of 31 Dec 24. 10- and 30-Year comparison reflects Bloomberg Valuation Service (BVAL) AAA Muni Curve and US On-/Off-the-Run Sovereign Curve. AA Muni reflects the Bloomberg AA Muni Bond Index. A Muni reflects the Bloomberg A Muni Bond Index. BBB Muni reflects the Bloomberg BBB Muni Bond Index. HY Muni reflects the Bloomberg High Yield Muni Bond Index. AA Corp reflects the Bloomberg AA Corporate Bond Index. A Corp reflects the Bloomberg A Corporate Bond Index. BBB Corp reflects the Bloomberg BBB Corporate Bond Index. Taxable equivalent yield considers top marginal tax rate of 40.8%. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator or a guarantee of future results.⁶ Source: Bloomberg. As of 31 Dec 24.⁷ Source: Bloomberg. As of 31 Dec 24.



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