

MUNICIPAL BOND INSIGHTS

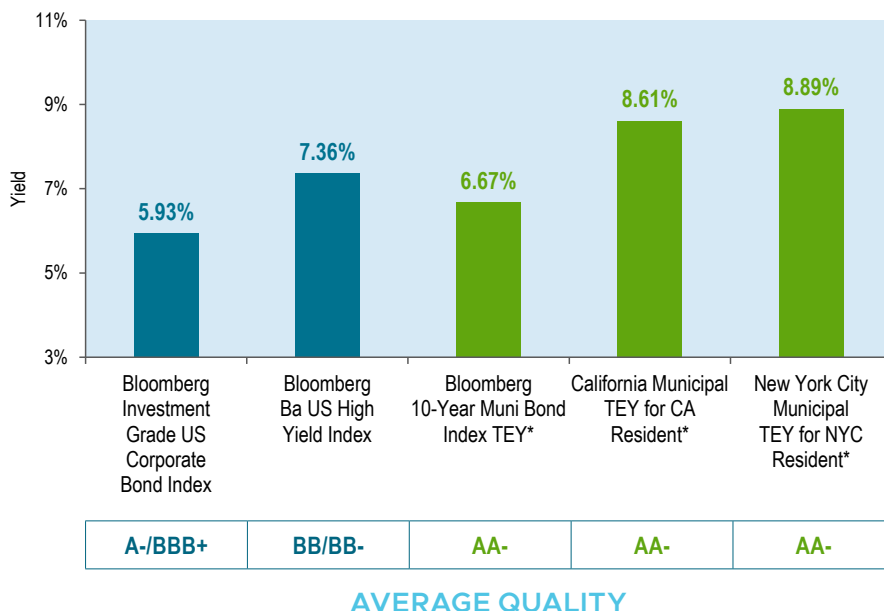
# MUNICIPAL TAX-EQUIVALENT YIELDS RIVAL RISKIER ASSET CLASSES

The sharp rise in tax-exempt yields over 2022 has created a much more attractive entry point for municipal investors. As of October 31, the yield on the Bloomberg Municipal Bond 10-Year Index was 3.95%, its highest point in over a decade. If we restate that level using a tax-equivalent yield, we can see how favorably municipals compare against other, riskier asset classes.

**Chart 1** compares the tax-equivalent yields for an investor in the highest marginal tax bracket (37.0% federal + 3.8% health care surtax) across two major fixed income asset classes: US corporates and municipal bonds.

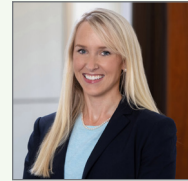
Municipal bonds can offer a similar tax-equivalent yield to taxable alternatives, only municipal bonds come with higher credit quality and lower historical default risk — favorable characteristics as we move deeper into a global tightening cycle. Based on S&P data, the average US public finance default rate during the global financial crisis in 2008 and 2009 was 0.02% versus 4.28% for US Corporates.

**CHART 1**  
Yield Comparisons Between US Corporates and Municipal Bonds



As of October 31, 2022

\*Tax-equivalent yield (TEY) calculated using the highest income tax bracket (37.0%), health care surtax (3.8%), California tax (13.3%), and New York City tax (14.78%). The tax-equivalent yields for California and New York City municipals were approximated by dividing the yield of the Bloomberg 10-year Muni Bond Index by (1-tax rate) for residents. See page 2 for source and Index descriptions.



**KARA M. SOUTH, CFA**

*Principal  
Municipal Bond Portfolio Manager*

To determine the tax-equivalent yield — the pretax yield a taxable bond would have to offer to equal that of a tax-exempt municipal bond — we use this formula:

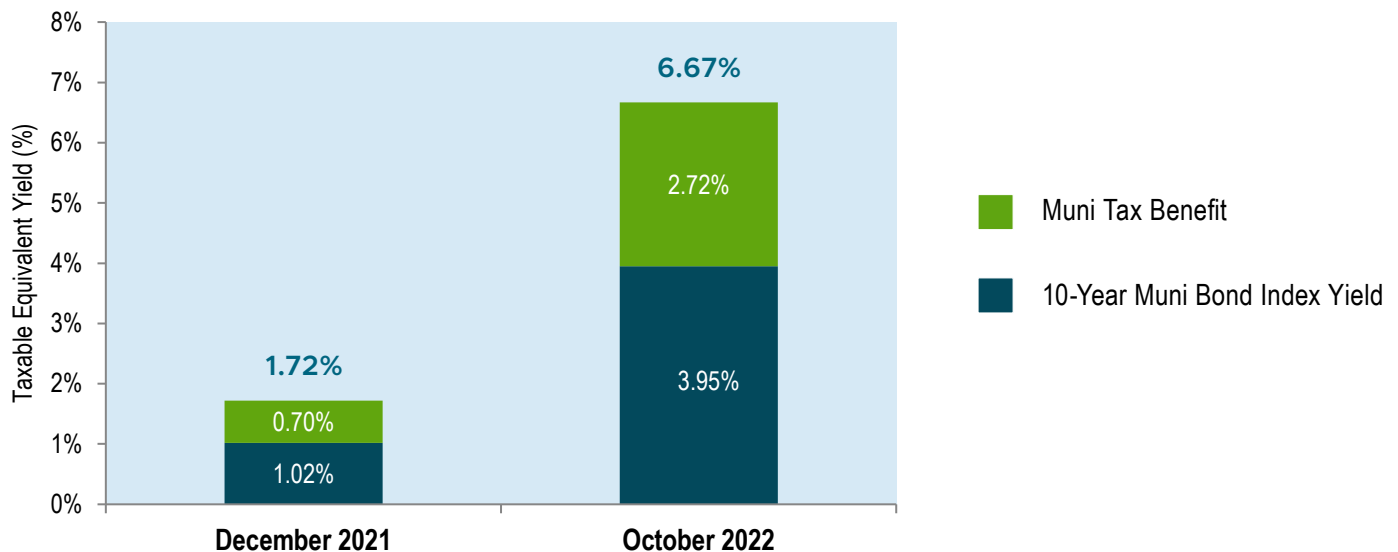
$$\text{Tax-Equivalent Yield} = \frac{\text{Tax-Exempt Municipal Yield}}{(1 - \text{tax rate})}$$

# MUNICIPAL TAX-EQUIVALENT YIELDS RIVAL RISKIER ASSET CLASSES *continued*

In **Chart 2**, you can see that the change in yields for the municipal market this year has meant an even larger expansion in tax-equivalent yields. In fact, for every 25 basis points in absolute municipal yields, the tax-equivalent yield increases by 42 basis points, making municipal yields that much more attractive for individual investors in the highest tax bracket.

In a market dominated by retail investors, absolute and tax-equivalent yields can drive decision making, as interest tends to grow when certain thresholds are met and crossed. In today's environment, this shift in sentiment may first require some stabilization in the broader market, but at some point, we expect these levels will elicit considerable demand as an attractive entry point.

**CHART 2**  
Rising Yields Means Even Larger Expansion in Tax-Equivalent Yields



As of October 31, 2022

**DISCLOSURES:**

Sources for data include Municipal Market Data, Bloomberg, and GW&K Investment Management. The Bloomberg U.S. Corporate - Investment Grade Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers. The Bloomberg High Yield Ba Index, a subset of the Bloomberg High Yield Index, is an unmanaged index comprised of fixed rate, publicly issued, non-investment grade debt registered with the SEC where the middle rating of Moody's, S&P and Fitch is Ba. The Bloomberg 10-Year Municipal Bond Index is comprised of investment grade national municipal bond issues with a maturity range of 8–12 years. Indexes are not subject to fees and expenses typically associated with managed accounts or investment funds. Investments cannot be made directly in an index. GW&K assumes no responsibility for the accuracy of the data provided by outside sources. This represents the views and opinions of GW&K Investment Management and does not constitute investment advice, nor should it be considered predictive of any future market performance. Data is from what we believe to be reliable sources, but it cannot be guaranteed. Opinions expressed are subject to change. **Past performance is not indicative of future results.**