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**RACHELLE AKUFFO, YAHOO:**

Let's get a read on MUNI bonds with David Hammer, Head of Municipal Bond Portfolio Management at PIMCO. Thank you for joining us this morning. So talk about the landscape for MUNI bonds because you're so welcome. A lot of people are more familiar with corporate bonds and treasury bonds. Talk about the space that MUNI bonds face here.

**DAVID HAMMER, PIMCO:**

Yeah, well, MUNI bonds, the most common feature that they are tax-free to US investors in the top marginal tax bracket. And some key differences, you know, the shape of the curve, longer maturity MUNI’s today actually have higher yields than shorter maturity MUNI’s much different than the treasury market or the corporate bond market. But just like corporate bonds, treasury bonds, MUNI bonds do expect to benefit from a change in posture here by the Fed. Inflation has peaked. The Fed told us as much yesterday pricing in more cuts now in 2024. And the economy is beginning to slow. We see a stagnant economy here at PIMCO. That's a pretty good macro backdrop for MUNI bonds in terms of both earning higher tax yields, but also the chance to benefit from capital appreciation.

**AKUFFO:**

So in the move by C2 group, the bank has said that they've not really seen the overall returns that they would have liked in the MUNI business. Is that something that you expect to continue into 2024?

**HAMMER:**

Well, you know, one of the reasons that the MUNI curve is steeper, that longer maturities offer higher yields is that banks have been less present. Their tax rates are lower today than they were before tax reform in 2017, moving from a 35% tax bracket down to a 21% tax bracket. So we do think banks are likely to be less present in the MUNI market. We see this as an opportunity for investors to really step into the void that they're creating here and buying bonds with higher yields than what we would have typically seen when banks were a bit more active.

**AKUFFO:**

And I want to ask you about the Domino effect, because at the local level at least, we see those sorts of bonds backed by property taxes. So when you look at what we're seeing currently with property taxes, what is that telling us about what to expect in the coming year?

**HAMMER:**

Yeah, it's a pretty positive indicator for local, MUNI credit quality. Most local MUNI bonds that are backed by property taxes, and the repayment mechanism, it's based on what are houses worth versus the assessed values. And what's fairly typical in the MUNI market assess values lag. And that's happened over the last couple of years here. Home price appreciation is up 10, 15, 20% in some local areas. MUNI bonds that are backed by property taxes, the assessed values. So what are they on the tax roll? Those are just beginning to catch up. It takes time as property values are reassessed or homeowners sell to new homeowners that pay a higher property tax. And that's really good for local credit quality. We expect continued improvement over the next few years.

**AKUFFO:**

So David, we know that so far, a lot of people still have some cash on the sidelines or they reap the benefits of investing in some of these short-term bond yields. So then what can they do at the end of the year? Keeping taxes in mind as they're trying to invest in the MUNI bonds market.

**HAMMER:**

Yeah, so I take two important things here. One is that the short end of the yield curve in the MUNI market, not the place to be in our view. Longer maturity bonds offer better tax-adjusted returns. An appropriately structured portfolio can earn 3.5% to 5% tax-free. That's equal to about six and a half to eight and a half percent before taxes. So really near equity-like returns with less risk. And while there's no such thing as a free lunch, you know, taking a tax loss is pretty close. And investors have the opportunity today to really re-examine their MUNI allocation, move out of maybe one mutual fund or one ETF or an individual bond into a different bond that potentially offers a higher yield and also lock in that tax loss to offset capital gains.

**AKUFFO:**

And so what would you say would be the biggest headwind for MUNI bonds in 2024?

**HAMMER:**

Well, you know, a lot of the headwinds that we've seen here have really abated that the last few years have been about higher inflation, higher interest rates, and outflows from the MUNI market. All of those look poised to reverse in our view. That said, there are some pockets in credit markets that, you know, are not as rosy as others. Areas that maybe haven't recovered as strongly from the pandemic, big urban areas, the transportation systems that support them. And then in healthcare sectors, so the senior living, not-for-profit healthcare issuers that can access the tax exempt bond market, they've been squeezed, but squeezed by wage inflation. It's really hurt their margins and their profitability. We think that's an area still to be a bit cautious if wage inflation takes a bit longer to ease in some of these healthcare related sectors.

**AKUFFO:**

Appreciate you breaking that down for us. I don't think MUNI bonds get enough love in this environment. Appreciate you joining us. David Hammer, Head of Municipal Bond Portfolio Management at PIMCO. Thanks so much.

**HAMMER:**

Thank you.