Abrdn's Mondillo On The Muni Market's Year Of Wild Swings

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Chuck Jaffe, in this episode of The NAVigator podcast interviewed Jonathan Mondillo, head of North American fixed income for abrdn. Read the Q&A below as Jonathan says that 2023 has been a year of wild moves in the municipal bond market, performing well in January before selling off in one of the worst months of February ever, setting up a March rebound until the banking crisis hit. Most of those movements have been driven by macro headlines, and Mondillo says that investors want to drill down moving forward, focusing on finding credits that can outperform in a market that is likely to slow down and ignoring the big-picture pressures that are driving the broad trend in the space.

Jonathan Mondillo

The podcast can be found on AICA's website by clicking here: https://aicalliance.org/alliance-content/pod-cast/

CHUCK JAFFE: Jonathan Mondillo, head of North American fixed income for abrdn is here and we're talking muni bonds, and this is The NAVigator. Welcome to The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, a unique industry organization that represents all facets of the closed-end fund industry from users and investors to fund sponsors and creators. If you're looking for excellence beyond indexing, The NAVigator's going to point you in the right direction. And today it's pointing us in the direction of Jonathan Mondillo, head of North American fixed income at abrdn. You can learn all about the firm at Abrdn.com, but abrdn is A-B-R-D-N, so take out the Es, Abrdn.com, and by the way, on Twitter @abrdn_US. To learn more generally about closed-end funds, interval funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. Jonathan Mondillo, welcome to The NAVigator.

JONATHAN MONDILLO: Chuck, thanks for having me on.

CHUCK JAFFE: So these are really interesting times, stock and bond market kind of telling us different stories, but before we get into your outlook and find out what you're seeing in muni bonds and what you see ahead, let's talk just a little bit about abrdn. Because abrdn has its own approach to fixed income and we should know what that approach is, especially right now in times that, like we haven't invested in times like this in a long time.

JONATHAN MONDILLO: Yeah, certainly, and you touched it I think with your opening there, and abrdn has a very unique platform relative to other bold bracket firms and/or other small family offices of which I've worked at both in my career and I think it's uniquely positioned for really a couple different reasons. One is we are one global fixed-income platform really across the asset classes, so me, myself being a portfolio manager on our municipal debt strategy as well as the head of North American fixed income, I don't sit separately or separate and aside from our corporate bond managers, our multi-asset managers, or our credit managers, we're part of one platform and I think it really frees us up to free-flowing information, cross-idea generation, which ultimately helps both our wealth clients as well as our institutional clients which like to invest across different asset classes. I think the second key differentiator versus maybe some other asset managers is that we put, I think, a greater emphasis on where we're getting out alpha generation from, in particular an emphasis on bottom-up credit fundamentals, so less so focused on some of the macro noise, especially in our corporate bond strategies and our credit strategies. And I'll probably caveat that with saying as we get into more of municipal public finance strategies, in particular shorter duration, ultra-short duration strategies, maybe more of an emphasis on macro drivers. But by and large we'd like to see most of our alpha generation coming from bottom-up credit fundamentals here at abrdn. So again, two key differentiators I think that ultimately contribute to outperformance in our strategy.

CHUCK JAFFE: Then let's look quickly at the muni market this year so far from two perspectives; the top-down perspective, what's going on in the bond space generally with interest rates and the rest, and the bottom's-up, are there good opportunities out there, worthwhile opportunities given what else is available in the number of alternatives in fixed income?

JONATHAN MONDILLO: So when we're looking at the municipal bond market, thus far this year it's been quite choppy. A lot of the performance has been following what we've seen in those macro drivers, so what the Fed is doing, where that's pushing the Treasury market around. So as we do a bit of a postmortem through the first three months of this year, the municipal market performed very well through January and saw a subsequent selloff and really one of the worst Februarys on record. As Treasury rates moved up, some of the macro data points coming in January were rather bullish, we still had a tight labor market, inflationary pressures became the concern as we got into February. Now as that abated, we saw a really strong rally headed into the banking crisis that we saw as a result of SVB, First Republic Bank, and some of the other regional banking institutions midway through March. So March saw really positive returns within municipals, again to your point, driven by some of those macro headlines. Now what have we been focused on, which I think investors should continue to focus on, is really what's going to generate long-term positive net returns to investors and which sectors, which issuers will ultimately contribute to those positive returns. So when we look at things from a bottom-up perspective, headed into what might be an economic slowdown starting to get to the latter stages of this expansionary environment as we get to the later stages of this year, we're focused on credits that we think outperform in that slowdown environment. Some of the non-cyclicals or even countercyclical issuers within education sector, the healthcare space certainly are areas that we like at the moment. But again, municipals tend to be a bit idiosyncratic, I think it's important for active managers to focus on those individual issuers and what the drivers are with that individual bond that you're looking at. Less so from a macro standpoint, "Oh, we like education.," "Oh, we like healthcare at the moment," more so, "We like this issuer within healthcare or this issuer within education."

CHUCK JAFFE: That being the case, supply matters, right? What's happening with the supply in the muni market, given the rate picture and the demand where we've gone from there is no alternative to stocks to there's plenty of alternatives. There are reasonable alternatives, there's pay attention to the yield, so it's TARA, it's PATTY, it's whatever acronym you want to use for yield right now. Is there enough supply?

JONATHAN MONDILLO: Absolutely. I think it's been a difficulty with putting money to work thus far this year, so when we look at the supply in the municipal debt markets on a year-to-date basis it's off north of 25% relative to where we were last year. What does that mean? Well, it just means that our job is that much more difficult in deploying assets, and deploying new money and new capital to municipal bonds, and opportunities for the municipal bond space. That being said, I think it also will create more opportunities as we get to the second part of the year. I think the key driver to the reasons why we haven't seen as much issuance this year is really twofold. One, it's maybe just a bit of sticker shock from municipal issuers, they're not used to coming to market at these all-in yields of 4%, in some instances 5%, so I think they've maybe hit the pause button on issuance. And then the second reason is just the credit environment and the volatility that we've seen. It hasn't been a very good environment to be issuing in with the day-to-day changes that we've seen in the overall market. That doesn't bode well when you're trying to bring deals to market. But I think the one positive that comes from [inaudible], municipalities still need to fund their capital projects, they still need to fund their budgets, and ultimately need to come to market with a capital market. So I think our expectation is while issuance is off, it's going to pick up in the latter stages of this second quarter and certainly by the second half of this year. So I think municipal investors that maybe have had a difficult time putting money to work this year certainly will be able to as we get to the second half of this year. And I think maybe just as a short follow-up, there's never been a better time to be investing in parking places, so cash or cash alternative areas of the municipal debt market. We've got a perfect solution for that, abrdn Ultra Short Municipal Income Strategy, ATOIX, I think we're seeing positive flows into that strategy as a direct result in that supply versus demand mismatch. So investors parking it into that vehicle, yields at the front end in those cash alternative vehicles extremely high at the moment, so it's no better time I think for investors to be faced with that difficult scenario, just putting money aside in those cash alternative vehicles.

CHUCK JAFFE: You've talked about the opportunity that's there, what you see coming, but you've also talked in some terms that make it clear you've got some concerns between this space in there. So what is your interest rate outlook? I mean, we just saw this week the latest CPI numbers, they make it very clear, "Hey, everybody who is looking for I bonds probably isn't going to be looking for I bonds moving forward." So what's your rate outlook for the rest of the year?

JONATHAN MONDILLO: Yeah, we saw the CPI print came mostly in line, maybe a little bit weaker, a little bit softer than what was expected. So I think that's good to see, right? Our expectation is that we do get another 25 basis point hike in May, obviously there's more, to your point, to be seen between now and then certainly when we get to the June-July timeframe and the latter stages of this year with Fed policy and Fed meetings, so I think it's really going to be data dependent. I think the benefit for investors is that whether we are in a higher for longer scenario, or as we get to the latter stages of this year and start to see rates come in possibly out of the Fed and start to see some cuts as the market's priced in, I think that both benefits fixed income and coupon clipping investors. So again, our outlook within the municipal bond scene is that we see 25 basis points in May and we get a pause. I don't think we're expecting to see cuts, although we are at the corporate level, and our economists at abrdn, I think the municipal bond team might think otherwise. But certainly for fixed-income investors, high coupon, high yields that you're presented with both in the municipal space and outside of it like corporate bond yields and investment grade north of 5%, fixed income looks like a really attractive asset class to be deploying money to independent of whether or not we see cuts by the end of this year.

CHUCK JAFFE: Jonathan, really appreciate that take. Thanks so much for giving it and joining me on the show.

JONATHAN MONDILLO: Excellent, thanks Chuck. Thanks for having me.

CHUCK JAFFE: The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe. And yes, that's me, and you can check out my show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more about interval funds, closed-end funds, and business-development companies go to AICAlliance.org, the website for the Active Investment Company Alliance. They're on Facebook and LinkedIn @AICAlliance. Thanks to my guest Jonathan Mondillo, head of North American fixed income for abrdn. You can learn about the firm at Abrdn.com, spelled A-B-R-D-N, and on Twitter @abrdn_US. The NAVigator podcast is new every Friday, ensure you don't miss an episode by going to where you get the good podcasts and following us there. We'll see you again next week, until then, happy investing.

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