OPPENHEIMER
MUNICIPAL STRATEGY AND RESEARCH
Municipal Basis Points – Weekly

March 28, 2023

Municipal Market Comments

Lights, Camera, Action…Cut?

Last week could not end soon enough. FOMC anxiety came together with continued banking sector stress and the markets behaved in typical fashion when there is global uncertainty and unclear monetary policy guidance. As widely anticipated and after much internal debate, our Central Bank unanimously approved a 25-basis point hike in the Fed funds rate, raising the target range, for a ninth time during the current tightening cycle, to a near 16-year high of 4.75% - 5%, and setting market sights on the early May meeting.

Aside from the obligatory mission to drive inflation down to its 2% target, the FOMC threw the markets a softer pitch by stating, ***"The Committee anticipates that some additional policy firming may be appropriate in order to attain a stance of monetary policy that is sufficiently restrictive to return inflation to 2 percent over time."*** The policy statement from the previous meeting referenced the need for ***"ongoing increases in the target range"*** as the likely trajectory, and so the nuanced adjustment should not be lost on nervous markets. With respect to the Fed's balance sheet management, the quantitative tightening cycle is expected to hold course, yet we do hope that the Fed could yield flexibility if necessary.

At the beginning of his post-meeting press conference, Chair Powell provided commentary on the current banking stress, underscoring the ample capitalization and overall soundness and resiliency of the banking system as well as clearly stating that deposit flows have stabilized and that the Fed's newly missioned funding mechanism now available at its window, which allows borrowing reserves at par, maintains ample liquidity. ***Mr. Powell expressed the Central Bank's desire to await incoming data surrounding potentially evolving tightness of household and business credit conditions and to assess such tightening affects upon future policy actions.***

The array of dropping shoes began with the collapse of SVB and subsequent casualties have been headlined both here in the U.S. as well as across the European continent. ***While additional names could be added to the list, Chair Powell does not envision systemic failures (and we agree), yet the banking woes could produce contagion across other confidence and growth-centric activities.*** This week opened with an

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identified suitor for the majority of SVB's assets as well as diminished anxiety over the European banking system. If there is a false sense of security to be had, however, let's not fall into it.

As mentioned, no sooner does one FOMC meeting conclude, when the next one assumes center stage. Chair Powell provided affirmation that the Central Bank considered a pause at last week's meeting and so, logically, there are expectations that a pause is on the table for May. ***Turning to the ever-changing futures contracts, we see that the markets and the Fed are once again reading from different scripts. Chair Powell made it clear that the Central Bank's base case neither includes recession nor a rate cut in 2023. The contracts are pointing to even-money for a May rate hike, with odds of easier policy advancing thereafter.***

At the risk of sounding like a broken record, we have now witnessed 475 basis points of tightening over the past year with historically significant velocity. Let's recall that we were prepared to make the case for a pause at last week's meeting. ***Should events and circumstances support a monetary cease-fire or even hold steady with evidence of further abating inflationary pressure sprinkled with one or more questionable bank profiles, we would sound an even stronger argument for a pause.***

We have consistently recognized the importance of pursuing a tightening cycle in order to arrest runaway inflation, and while the Fed's timeliness to its tightening sequence could be called into question, we have largely been in the Central Bank's corner. Having said this, ***the data reveals that much of the inflation bite is responding to policy actions, certainly if we consider housing, commodities, and goods inflation generally. Services inflation remains sticky, with heavy demand influences from the leisure and hospitality sector, one of the more deeply shuttered areas of the economy during the pandemic's reign that continues to broaden its recovery.***

While it is difficult to equate recent bank-related credit tightening ***to a basis-point range of increases in the funds rate, recent events have given the Fed some reasonable assistance. An observable credit contraction may very well yield disinflationary, if not deflationary, results upon the economy and the affects for overall growth performance can be quite material.*** In their revised summary of economic projections (SEP), Federal Reserve officials revised slightly lower their median 2023 forecast for change in real GDP from the December projections, from 0.5% to 0.4%. Their 2024 estimate was revised down to 1.2% from 1.6% posited last December.

In our view, the banking stress will likely help to move inflation lower from still-elevated levels, and the downside risks upon GDP could exceed the Fed's own growth forecasts. Admittedly, the consumer is resilient and keeps growth performance within positive territory. However, future participation requires close monitoring as overall activity slows, with collateral damage from the banking dislocations and ensuing CDS narrative potentially becoming more visible. Future consumer engagement will be particularly assessed in the areas of housing, spending, and general levels of consumer confidence.

With the FOMC meeting now in the rear-view mirror and Fed officials free to provide individual commentary until the next "blackout period", ***there seems to be uniform agreement among policymakers that decisive action was taken to prevent a systemic banking crisis, leaving the inflation fight job number 1 as demand remains quite strong, and stressing that the Central Bank possesses a different set of tools for different circumstances.*** In the SEP, policymakers held steady their 2023 forecast for the funds rate from the December outlook, targeted at 5.1%, and the 2024 projection was raised from 4.1% to 4.3%. Futures are not presently signaling a peak funds rate at or above 5% through the balance of 2023, and in fact are projecting a year-end rate approximating 4.25% (as of this writing), just about 85 basis points lower than Fed expectations.

Let's agree that the banking system is well-capitalized and the problems stem from duration mismatches, as opposed to the presence of poorly performing/non-performing assets on the bank balance sheets. ***We suspect that enhanced oversight may bring about greater supervisory and regulatory parity between the large money center banks and the regional banking participants, and should higher capital requirements be mandated for regionals, there would likely be downward impact upon loan activity. As this scenario plays out, there would be another fly in the growth ointment, potentially helping to tip the GDP scales closer to zero or perhaps below.***

Since the conclusion of last week's FOMC meeting, we have witnessed a see-saw movement of sorts in UST bond prices. Treasury yields moved lower for a couple of trading sessions, held close to steady along many maturities last Friday, and advanced higher, breaking from YTD lows, during yesterday's trading session to finish closer to where they were, or even higher, for 3-month and out tenors at the end of FOMC day. Longer-term maturities, generally being less sensitive to monetary policy shifts, showed smaller rate increases. The flight-to-quality trade appeared to reverse course as easing bank contagion fears materialized, and we suspect some profit taking ensued. ***Today's (Tuesday) bond market selling pressure can be linked to uneasiness ahead of this week's GDP and PCE reports.***

The Treasury market is expected to remain pressured this week given a heavy corporate calendar, yet ***the flight-to-quality bid is far from over and it would not be a surprise to see even lower odds for a May rate hike, thus bringing on further divergence between the markets and the Fed. Recession seems embedded in the Treasury's curve inversion, yet there is still plenty of inflationary sensitivities to go around. The bond market wants the Fed to begin the rate cutting cycle soon as it believes that further tightening against a backdrop of banking stress could plunge our economy into a deep and protracted recession.***

For now, Treasury yields are likely to stay range-bound, with shorter tenors such as the 2-year likely to respond downward to a Fed pivot, should one come about, and the curve will be assessed for any steepening bias. Let's recall that Chair Powell's Congressional testimony earlier this month brought about a 2s/10s inversion of over 100 basis points on March 8th for the first time in over forty years, as bets on a likely recession accelerated and notions of extended rate volatility took hold.

We have already seen the impact made by the banking stress and the attendant outlook for a cut in rates upon the curve, with the 2s/10s inversion tightening in to its current 41 basis points as the overall curve followed a steepening trajectory. From March 8th to today, the 2-year benchmark yield declined by 100 basis points.

Municipal bond price movements remain tethered to the vagaries of the U.S. Treasury bond market, yet the asset class has been able to flex a noted degree of independence. Today's Treasury bond market seeks conviction, preferring to back away its response from the next headline, data point, FOMC meeting, or from the next banking shoe to fall, but munis seem to reflect a demand proposition against thinner supply of primary and secondary product.

With just a few days left in March, muni market participants should be pleased with both MTD and YTD returns against an unrelenting backdrop of volatility, yet we do concede that light primary volume, given the weariness over FOMC and banking stress, is playing a hand in performance. While munis are underperforming UST on both time measures, we are not all that disappointed given that munis generally underperform a bond market rally and that the asset class is exceeding expectations.

Having said this, ***we believe that munis are well-poised to preserve the flashing green through April as long as constructive technicals and market sentiment for a sputtering Central Bank tightening campaign hold in. The flight-to-quality bid will likely be more than just a casual visitor with munis expected to be a key beneficiary given the inherently defensive attributes offered by the asset class. Reinvestment needs have been seasonably light, but this dynamic will be changing as we move through the coming months.***

We would also anticipate a pick-up in new-issue supply should Fed messaging become more issuer-friendly, with the potential for lower interest rates a likely deal sweetener. While not an absolute, we are anticipating more normalized rate movements, and for this to occur we need to see less volatility and more investment conviction. We continue to posit that any tax-season related selling will take a back seat to a host of macro-level concerns over the next several weeks.

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Fixed Income Market Indications[1]

March 29, 2023

For Institutional Use Only

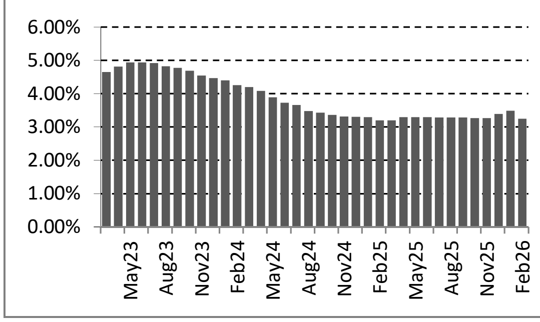
Cash Market Indices: [2]

Term	Discount Rate (%)	90 Day Rate Change
ON SOFR	4.83	0.53
1 M LIBOR	4.84	0.47
SOFR 30D AVG	4.61	0.57
3 M LIBOR	5.16	0.41
6 M LIBOR	5.21	0.07
1 Y LIBOR	5.16	-0.28
FED FND ACT	4.82	0.50
FED FND TGT	5.00	0.50
O/N REPO	4.82	0.52
SIFMA	3.97	0.31

Commercial Paper (A1/P1): [3]

Term	Discount Rate (%)	90 Day Rate Change
7 Day	4.79	0.50
30 Day	4.95	0.54
45 Day	4.98	0.55
60 Day	5.04	0.57
90 Day	5.11	0.53
120 Day	5.16	0.45
180 Day	5.15	0.17
210 Day	5.12	0.03
240 Day	5.07	-0.08
270 Day	5.05	-0.11

Fed Funds Futures Contracts: [4]



U.S. Treasury Bills: [5]

Term	Discount Rate (%)	90 Day Rate Change
30 Days	3.74	0.35
60 Days	4.18	0.24
90 Days	4.43	0.21
120 Days	4.54	0.17
180 Days	4.52	0.04
360 Days	4.52	-0.09

U.S. Agency Discount Notes: [6]

Term	Discount Rate (%)	90 Day Rate Change
30 Days	4.62	0.62
60 Days	4.72	0.35
90 Days	4.76	0.40
120 Days	4.79	0.50
180 Days	4.80	-0.59
360 Days	4.66	0.26

Institutional Money Market Mutual Funds: [7]

Fund Name	1 - Day Yield
Prime: Federated Money Mkt Management	4.84
Prime: Dreyfus Cash Mgmt	4.75
Prime: Western Asset Inst Liquid Reserves	4.90
US Govt: Federated Gov't Obligations Fund	4.68
US Govt: Fidelity Government Portfolio	4.71
US Govt: Western Asset Inst Gov't Reserves	4.72

Term Markets: Bloomberg Fair Market Value Curves [8]

Taxable Market	*1 year*	*2 Years*	*3 Years*	*4 Years*	*5 Years*	*10 Years*	*20 Years*	*30 Years*
U.S. Treasury Notes & Bonds	4.60	4.13	3.90	3.80	3.73	3.58	3.95	3.77
US Government Agency	4.73	4.31	4.07	3.94	3.88	3.95	4.31	NA
US TXBL Municipal G.O. AAA	4.77	4.37	4.34	4.33	4.31	4.45	4.82	5.00
US TXBL Municipal G.O. AA	4.87	4.51	4.46	4.42	4.41	4.63	4.91	5.13
USD Corporate Composite A	4.98	4.76	4.61	4.55	4.55	4.81	5.23	5.13
Tax-Exempt Muni Market	*1 year*	*2 Years*	*3 Years*	*4 Years*	*5 Years*	*10 Years*	*20 Years*	*30 Years*
US General Obligation AAA	2.49	2.43	2.33	2.27	2.26	2.31	3.14	3.41
US General Obligation AA+	2.70	2.59	2.45	2.38	2.37	2.50	3.37	3.66

Bloomberg Bond Yield Forecasts (Weighted Average) [9]

Index	Q2 23	Q3 23	Q4 23	Q1 24	Q2 24	Q3 24
Federal Funds Rate	5.25	5.20	5.05	4.65	4.20	3.80
3 Month Term SOFR	5.13	5.05	4.86	4.53	4.05	3.63
2 Year US Treasury Yield	4.34	4.18	3.92	3.72	3.48	3.29
10 Year US Treasury Yield	3.65	3.59	3.49	3.41	3.35	3.28

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1) Rates quoted are as of the date shown, are subject to change, do not include sales commissions and may include a dealer spread. 2) Source: Bloomberg. FED FND ACT is Fed Funds Effective Rate. FED FND TGT is Fed Funds Target Rate. 3) Source: Bloomberg. Rates are composite of offered levels for A1/P1/F1 US Commercial Paper. 4) Source: Bloomberg. Federal Funds Futures contracts effective rates. 5) Source: Bloomberg. Rates are a composite of offered levels for U.S. Treasury Bills. 6) Source: Bloomberg. Rates are a composite of discount offered levels received from brokers & dealers for US Agency Discount Notes. 7) Source: Bloomberg. Annualized 1-Day Distribution Yield. Yields can change daily when the NYSE is open. Please note that the minimum initial investment amount and minimum balance requirements can vary greatly between money market funds. Please contact us or read the prospectus for current minimums and availability of money market funds in your account. An investment in a money market fund is not guaranteed by the Federal Deposit Insurance Corp or other government agency. 8) Source: Bloomberg. Rates are derived from Bloomberg's option-free Fair Market Curves. 9) Source: Bloomberg. Fed Funds, 3-Month Libor, and 2-Year Treasury Forecasts from Bloomberg. Weighted Average results illustrated.

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USD Composite A

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US General Obligation AAA, AA+, AA-, A+

Bloomberg Composite Ratings are averages of Moody's, Standard and Poor's and Fitch. The indices are comprised of a basket of US Dollar denominated option-free Fair Market Value Municipal General Obligation bonds with maturity dates around the selected time period.

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A short term debt obligation backed by the U.S. Government with a maturity of less than one year. T-bills commonly have maturities of one month, three months, or six months. T-bills are issued through a competitive bidding process at a discount from par, which means that rather than paying fixed interest payments like conventional bonds, the appreciation of the bond provides the return to the holder.

U.S. Treasury Notes and Bonds:

A fixed-interest U.S. government debt security with a maturity from one to thirty years. Treasury securities make interest payments semi-annually and interest is only taxed at the federal level.

90 Day Rate Change

The difference between the current rate and the rate 90 days prior. Should 90 days prior fall on a date where the market is closed, the date is shifted to the last open market date beyond 90 days.

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