Nuveen's Ryan: Municipal Bonds Have Stabilized And Are Poised To Recover

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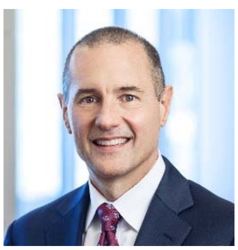
Chuck Jaffe, in this episode of The NAVigator podcast interviewed portfolio manager Tim Ryan of Nuveen, who runs the Nuveen Dynamic Municipal Opportunities closed-end fund. Read the Q&A below as Tim says that after a miserable first half of 2022 that lagged Treasury bonds, conditions have stabilized for muni bonds, which now have a more attractive yield curve and offer a better investment opportunity than Treasuries. Ryan says that the first-half selloff was more about technicals than about the quality of the underlying municipal bonds, which means that when the interest-rate picture stabilizes investors will worry less about credit quality in munis than in other areas in fixed income.



Tim Ryan

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

CHUCK JAFFE: Tim Ryan, portfolio manager for Nuveen is here, we're talking investing in municipal bonds now on 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 we are looking in the direction of municipal bond investing with Tim Ryan, portfolio manager for Nuveen, where he oversees a number of muni bond strategies including Nuveen Dynamic Municipal Opportunities. A closed-end fund, trades under ticker symbol NDMO, and a sister that's an open-end fund, Nuveen Strategic Muni Opportunities, that's NSIOX. You can learn more about the firm and its funds at Nuveen.com, but if you add Nuveen.com/CEF you will get directly to their closed-end fund offerings. And if you want to learn more about closed-end funds, business-development companies, and interval funds generally, check out AICAlliance.org, the website for the Active Investment Company Alliance. Tim Ryan, thanks for joining me on The NAVigator.

TIM RYAN: Thanks Chuck, my pleasure.

CHUCK JAFFE: Tim, we all just saw this week the Fed raised rates again. We know that there's more coming, but we've gotten to an interesting crossroads. You've got the bond market starting to look healthier, you're starting to get paid a little bit more, but you also have the prospects of rate hikes. So help us understand where the muni bond space is now, because like every other part of the bond world, it got hammered the first six months of the year.

TIM RYAN: Yes, boy, it has been a tough environment for fixed-income investors, and specifically for municipal investors which have been dealing with the overall rise in interest rate levels. But in addition to that, for much of the year, underperforming US Treasuries, and so it's been very soft and quite a challenge. But to your point, I think we've really seen a lot more stability in the municipal market particularly since about mid-May. A common comparison we do is munis to Treasuries and follow that ratio, and that has had a move significantly higher through mid-May. It's now moderated a bit, come down, and we're finding a lot more balance in our marketplace, a lot more two-way flow, both buyers and sellers. To the things you talked about, the back-up in rates has caught peoples' attention and some of the yields available in the market are compelling and significantly higher than what could have been achieved last December.

CHUCK JAFFE: How are they relative to taxable yields? We now are in a situation where the yield curve is at least moderately inverted, but the yield curve for taxable is not always the same for munis. So are they moving in sync or are they out of step right now?

TIM RYAN: They are definitely out of step, the Treasury curve is inverted. I looked at it today, twos tens on Treasuries were -11 basis points, on munis they're +60, and twos thirties for Treasuries, +12, and for munis, +129. So there's a lot more speculation in the Treasury market. You have a lot of synthetic ways to express a view to implement a strategy that are not available for municipal investors. And in addition, I think the municipal market is really a market of buyers and sellers, and real cash buyers and cash sellers. And sometimes we move in sync, but this year has definitely been one where we are not, and our yields and yield curves really reflect actual buyers and sellers within our marketplace. I think that's creating some opportunities in our market.

CHUCK JAFFE: Are those opportunities, because to some extent the downturn that we've seen, was the muni market being oversold? Is that what's happening or is the opportunity something else?

TIM RYAN: Well, I think what we had was a technical selloff, it's really not fundamental. This is a rate selloff, muni credit has held up quite well. Ever since, you can go back to the last presidential election and before, with the effect of the pandemic and the response, municipal credit has gotten a lot of support from the federal level and to help municipalities deal with the effects of the pandemic and coming out of that. In addition to that, tax revenues for many municipalities are really quite strong. So municipalities find themselves, from a fundamental standpoint, doing quite well, balance sheets have been enhanced. And in addition to that, I think some of the support has given, even credits that were maybe if not troubled but under more stress, a little bit more runway for which to address their problems and get their house in order. So we're seeing a lot more upgrades than downgrades in our space, and I think that's a good thing and one of the things that bodes well for our sector right now as we stabilize and I think are a little bit less affected by a one-way movement to higher interest rates, and now being much more balanced and two-sided.

CHUCK JAFFE: You talk about the underlying strength. I've had guests on my show who have talked about high yield and how high yield is now priced for a much greater default rate, one that we may or may not see. They think the default rate will get much worse than it is, but not necessarily what the market is pricing in. In the muni case, are we not seeing the investment community say that they expect a lot more of municipal problems? Because we went through a period where we had some really tough times in the muni space. We thought there were going to be worst times, we thought a couple of states might default and a couple of big cities and what have you. None of that wound up happening and everything's been pretty cool. Do we have any worry that those tough times are coming back?

TIM RYAN: It's a really good point, and I think one worth discussing, because I think fundamentally we are a bit different. Some of our big name credits like the Puerto Rico complex of credits, a lot of those have been restructured. And so some of the big problem areas have been resolved and have come out, and some of those credits now are much stronger than they were pre-bankruptcy. They were put in bankruptcy and come out of bankruptcy, and now are trading and are much healthier than they were. So that's a good thing, that's kind of in the background. Again, I point to the things that we've have, there's been financial support which has given many of these issuers a little bit more of a cushion. But the bigger and broader thing is that it affects the—with tactical high yield, I think the things we have to be looking for now going forward is not so much default per se, because I think we have protection there. But any time you see stress in other markets, and if we tilt from the inflation story to the recession story, and if that becomes a bigger issue going forward, while I may not be as concerned about some of the muni credits from a default standpoint, it's entirely possible that taxable and high-yield taxable credits could become relatively more attractive. Maybe it sells off more, it becomes more attraction to an investor that can invest in both the muni market and the taxable market. That might be someone like an insurance company or a bank that can go in either market, and that could put some pressure on spreads and where our bonds are trading. It may not affect defaults and put our underlying credits into default, but it could affect how those are trading. And that's going to be an important issue for us going forward, as we start to get inflation under control and focus more on underlying credit and the economy going forward.

CHUCK JAFFE: And lastly, I mentioned not only do you run the Nuveen Dynamic Muni Opportunities closed-end fund, NDMO, but also Nuveen Strategic Muni Opps which is NSIOX. Obviously in a closed-end fund you're able to do some things with more leverage and what have you. But of those two strategies, because they're sister funds they're obviously managed in a very similar way, but because of the tools you get in the closed-end fund is that better, easier to control, harder to control in times like this? Leverage is a good thing when the market's working for you, but the market right now is so crazy, help us understand the difference for the two as you're running them both.

TIM RYAN: Yeah, it can kind of cut both ways, Chuck. And that has happened. So a couple of things, first of all the toolbox is roughly the same in both funds and we can do similar things, and we'll trade them very consistently. Oftentimes if we're selling a bond in one or buying a bond in one, we'll be doing the same for both. Where it diverges a bit is there is a lot more leverage employed in the closed-end fund, so it magnifies the returns, whether it's on the downside or the upside. And that has happened this year. The biggest driver this year has been rates, that has put downward pressure on returns, and so those are more magnified in the closed-end fund. The nicer thing about the closed-end fund in this last downtown is just that, it's closed, so oftentimes in the early stages of the selloff, and I'd say much through the first half of the year, we were seeing significant redemption activity across the open-end fund complex and Strategic Opps was no exception. And so we have to manage the outflow more, so that you can be doing trades that could be shortening your portfolio, but unfortunately a lot of the money goes out the door and so you're not getting the full effect of shortening while you're raising money to meet redemptions. So that's kind of a negative to the open-end fund. But the flip side to that is that the closed-end fund employed a lot more leverage, and so the magnitude of the move was more pronounced in Dynamic Muni Opps. So some things working for one and against the other or vice versa during that environment, but we do manage them consistently, usually as I said, the returns, whatever the returns are will be more magnified in the closed-end version.

CHUCK JAFFE: Tim, really interesting. Thanks so much for joining me to talk about it.

TIM RYAN: Been a pleasure, thank you 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 hour-long weekday show on your favorite podcast app or by going to MoneyLifeShow.com. To learn more about closed-end funds, interval 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 Tim Ryan, portfolio manager for Nuveen, who oversees a number of muni bond strategies including NDMO, the Nuveen

Dynamic Municipal Opportunities Fund. You can learn more at Nuveen.com/CEF. The NAVigator podcast is new every Friday, ensure you don't miss anything by following along on your favorite podcast app. And until we do this again next week, happy investing everybody.

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