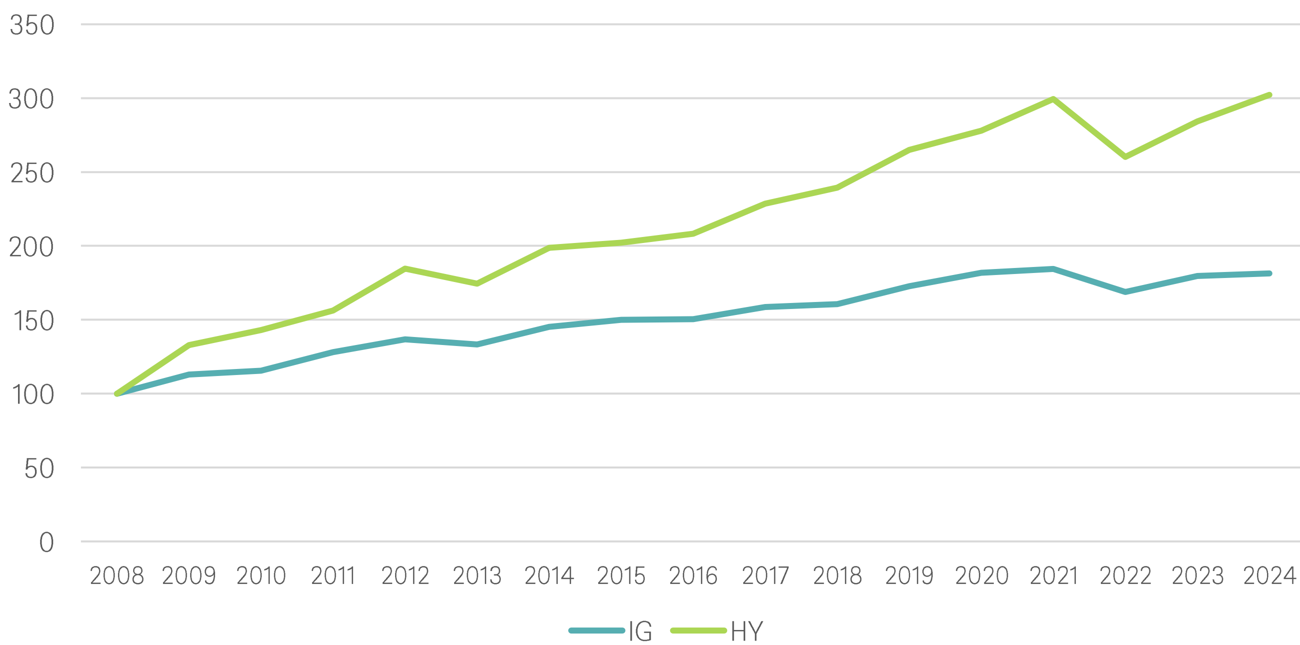
High yield returns are not created equal

- High yield municipal bonds as a category have outperformed the broader market since the financial crisis of 2008.
- However, returns by sector within the high yield municipal market have varied widely over that period.
- In turn, manager decisions around sector selection can have a material impact on the outcome for investors.

Since the 2008 financial crisis, the high yield segment of the municipal bond market has been the best performer over that period. Additionally, the Bloomberg Municipal High Yield Index return bested the Bloomberg Municipal Index in 11 of those 16 years. When it did underperform, it only lagged investment grade returns by roughly 2%, on average, in those calendar years. On the contrary, in years when high yield outperformed investment grade municipal bonds, the additional return was more than 6%, on average. Since 2008, the compounded annual return of the Bloomberg Municipal High Yield Index was 2.2% more than the Bloomberg Municipal Index.

Growth of $100 in Bloomberg Municipal High Yield Index vs. Bloomberg Municipal Index

(12/31/08 – 12/31/24)



Source: Bloomberg as of 12/31/24. Past performance is no guarantee of future results. Index returns assume reinvestment of all distributions and do not reflect fees or expenses. It is not possible to invest directly into an index.

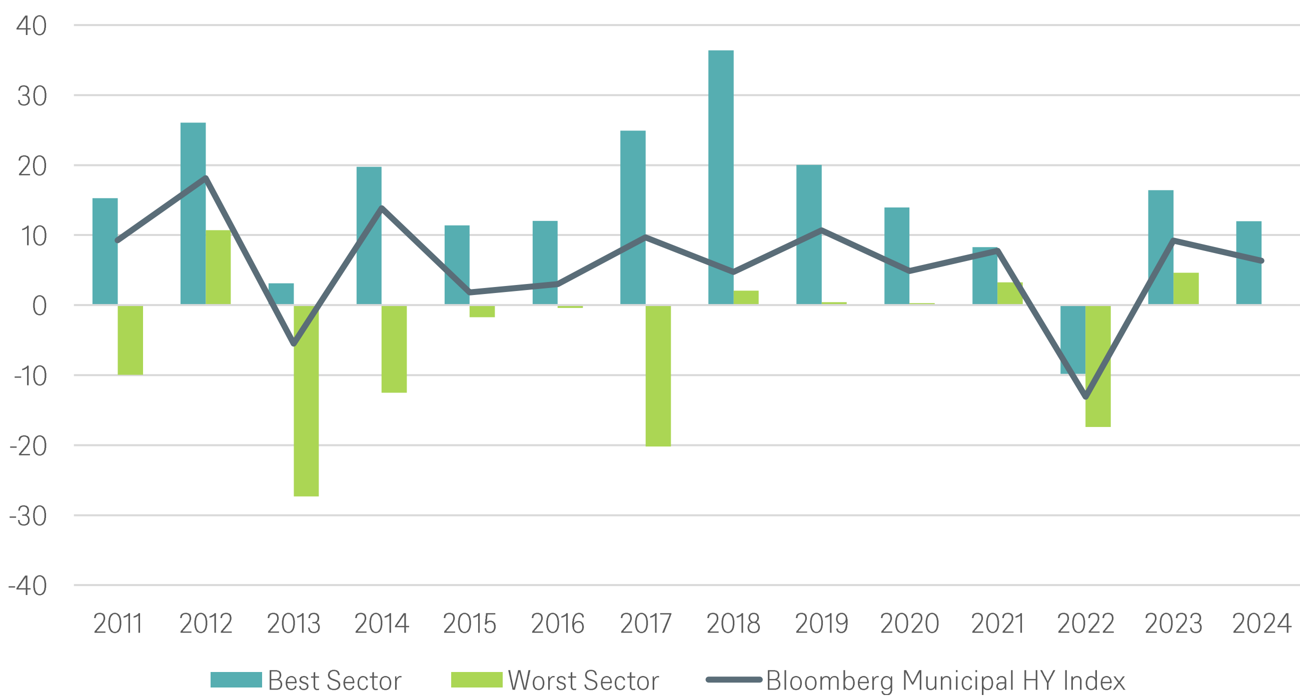
One aspect overlooked by many investors is the uniqueness of the municipal bond market given the large breadth of sectors, issuers and structures. This is especially true when looking at the high yield segment of the market. In 2024, the Bloomberg Municipal High Yield Index outperformed the Bloomberg Municipal Index by more than 5.25%. However, not all sectors of the high yield index experienced such robust performance. The range of outcomes by sector was significant with senior living bonds on the high end, returning 12%, and tobacco securitization bonds on the low end, returning 0.08%. Breaking down the individual returns within sectors is even more dramatic. Not all the performance was credit driven, as duration played a role in a year when benchmark interest rates increased.

The range of returns for sectors in the Bloomberg High Yield Index in each of the past two years has been approximately 12%, which was elevated over what was experienced in 2021 and 2022. In the past 14 years, the dispersion of sector returns has been even greater in certain years and averaged close to 20%. In 2017, the difference in returns for the best and worst sectors was more than 45% and has exceeded 30% in three years.

When drilling down into the specific bond returns within sectors, the differences become even more dramatic. Senior living, the best performing sector in 2024, had two issues which had a return dispersion of almost 80%! The top performing issue was for a Washington State care facility that returned 48.6%, while the worst performing issue was for a troubled care facility in Colorado that was down 31.3%. This highlights the importance of robust sector and security analysis for providing attractive returns and downside protection to investors.

Bloomberg High Yield Municipal Index Best and Worst Sector Returns

(12/31/11 – 12/31/24)



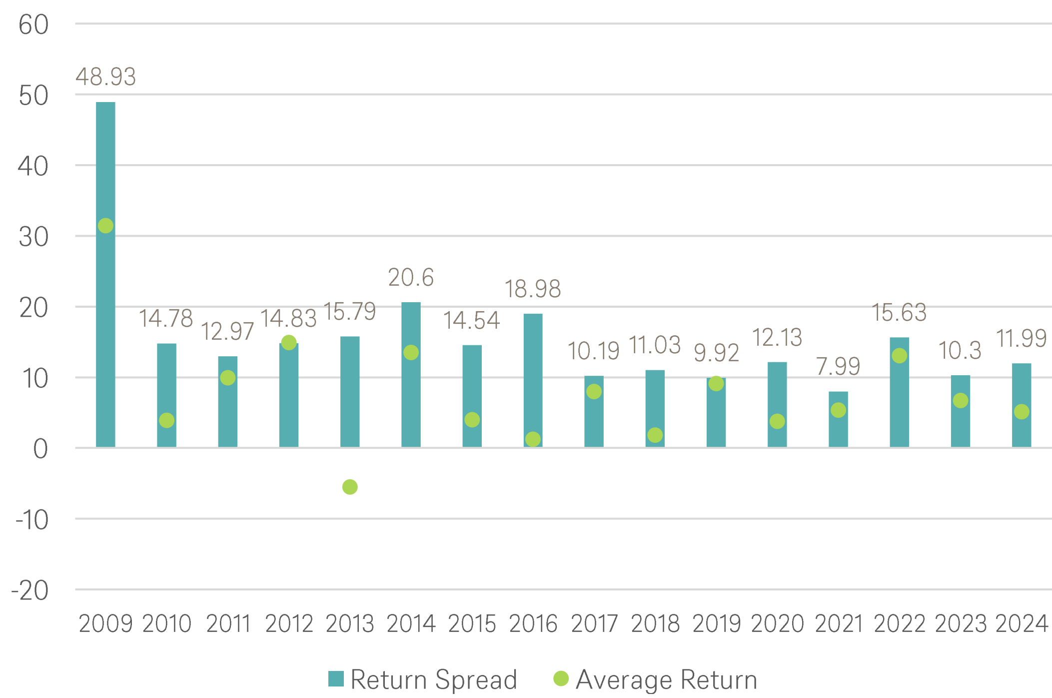
Source: Bloomberg as of 12/31/24. Past performance is no guarantee of future results. Index returns assume reinvestment of all distributions and do not reflect fees or expenses. It is not possible to invest directly into an index.

Bringing this into more practical terms for most investors, similar return dispersions can be seen when looking at the range of returns in the Morningstar High Yield Muni category, highlighting how different manager styles can have real impacts on end investors.

Over the past ten years, calendar year return differentials between the best and worst performing mutual funds/ETFs in the Morningstar High Yield Municipal Bond category have ranged between 10% to 49%. Most investors may be surprised by this fact given the view that municipal bond investments are typically considered less volatile. All-the-more reason for investors to have a good understanding of how a municipal bond manager allocates to the market.

High Yield Category Return Differential

(12/31/09 – 12/31/24)



Conclusion

When reviewing high level index returns, it can be tempting to think those index returns are easily achievable and fair representations of actual experience. Yet, considering how disaggregated the municipal market is with numerous sectors and thousands of issuers, it is important to remember how different returns can be, even for bonds in the same sector. This is especially relevant when looking at the high yield part of the market, where credit risk can cause large performance deviations. Not surprisingly, within the high yield mutual fund/ETF universe, returns also vary widely as active manager weightings can lead to wide variations in returns for investors. As the return differences reveal, all high yield is not created equal.

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