CLINTON
INVESTMENT MANAGEMENT

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Clinton Investment Management – Market Brief and Insights

What's Driving Interest Rates Higher? Oil

Where is the Opportunity? Munis

The fixed-income market is experiencing a rare, time-sensitive window of opportunity for investors. As global capital markets transition through a cooling economic cycle and a changing monetary policy environment, history shows that opportunities to capture historically high yields in traditionally lower risk municipal bonds can vanish rapidly. For high-net-worth investors, acting quickly to lock in tax-free cash flow, at levels seen only on select occasions over the past twenty years could increase after-tax cash flow levels for decades to come.

- Oil is the primary driver: If anyone wants to know what has been driving interest rates higher in the US and around the globe, the answer is very straightforward: higher oil prices. The correlation between the price of oil and US Treasury yields is over **90%** over the past three months, according to Bloomberg. The breaking news here is that it is not budget deficits or the US government's growing level of outstanding debt driving interest rates higher. Instead, the higher price of energy has been the primary catalyst pushing rates up around the world.

- Historic 8% to 10% Taxable-Equivalent Yields: High-grade and high-yield municipal bonds are currently generating some of the most compelling taxable-equivalent yields (TEY[1]) observed in the post-pandemic era. For investors in the highest tax brackets, especially when factoring in combined federal, state, and local taxes, nominal, taxable-equivalent Muni yields equate to historical equity-like returns of 8% to 10%, without exposure to equity, corporate, or private credit risks.

- A Shrinking Window for Peak Income: This highly unusual pricing anomaly represents a rare dislocation in the yield curve and broad fixed-income complex. As the broader macroeconomic cycle continues its shift, these high-income opportunities could vanish as quickly as they came, should oil prices decline, exerting downward pressure on inflation. What we know is that higher oil prices and corresponding higher interest rates are demand destroyers, not catalysts for faster economic growth.

- **Locking In Fixed-Rate Protections Now:** Investors have the opportunity to increase after-tax, fixed cash flow, preserving a predictable income stream for potentially decades to come, while positioning their portfolio for potentially significant capital appreciation, should rates drift lower over time, as is our expectation.

- **Maximum Insulation from Tax Erosion:** For investors residing in the highest tax brackets, the structural tax exemption of municipal securities offers immediate relief. It prevents the heavy tax drag that typically erodes fully taxable alternative investments, ensuring more cash flow stays in the portfolio.

- **Unmatched Generational Stability:** Backed by essential public infrastructure, utilities, and state or local government tax autonomy, high-grade municipal bonds boast historical default rates well below 1% over multiple decades, according to Moody's[2], offering a safe harbor in a late-cycle economy.

- **Unencumbered Asset Liquidity:** Municipal securities provide clean, reliable liquidity and predictable revenues, entirely free from predatory fee structures, opaque valuations, or capital-access restrictions.

If you would like to learn more about the best way to capture the most compelling opportunities we are seeing, please let us know.

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[1]The taxable equivalent yield to worst (TEY) is calculated by dividing the tax-exempt yield by 1- the maximum federal income tax rate of 40.8% (37% federal + 3.80% NII tax).

[2]Moody's: US municipal bond default and recovery rates, 1970-2024 | Default Report | Moody's