Wealth managers eyeing municipal bonds ahead of tax cut sunsets - Investment News

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From left: Janet Fox, James Warner, and Jeff MacDonald.

The Tax Cut and Jobs Act (TCJA) enacted by President Trump in 2017 increased the standard deduction and eliminated personal exemptions. It lowered marginal income tax rates across the scale. It imposed a $10,000 cap on the deductibility of state and local taxes (SALT). It increased the tax credit for each child under 17 from $1,000 to $2,000. It provided a 20 percent deduction for small businesses and also hiked the AMT exemption.

It's also sunsetting in 2025 leaving financial advisors with some big portfolio decisions to make. One of the bigger ones being whether to raise their clients' municipal bond allocations and, if so, by how much.

Munis are tax free, you know.

James Warner, LPL financial advisor and lead wealth manager at Warner Group, for one, says he is considering an increase in some client municipal

bond allocations of as much as 10 percent given the scheduled sunset of the TCJA in 2025.

“We will be keeping an eye on all the variations on this changing topic and will have to be ready to pivot quickly as the markets react. Of course, investors should always consult with a trusted financial advisor to ensure strategies align with their overall goals and risk tolerance,” said Warner.

Likewise, Eric Golden, founder and CEO of fixed income-focused fintech Canopy Capital Group, says advisors on his platform are likely to increase their allocations to municipal bonds as the TCJA approaches its sunset in 2025. The rationale behind this shift is rooted in the potential for higher taxes, which would turn up the spotlight on the tax-exempt nature of municipal bonds.

“Advisors are expected to accelerate their extension into short-term and intermediate-term bond portfolios as the Fed continues to cut rates, allocating a greater percentage of their fixed income exposure towards municipal bonds. While exact figures on allocation increases can vary by advisor and client needs, we anticipate a notable uptick in interest and investment as the 2025 deadline approaches,” said Golden.

Elsewhere, Janet Fox, LPL financial advisor and president of ACH Investment Group, has already started increasing municipal bond positions in some client accounts and says she plans to further expand allocations to munis next year.

“Some clients might be nervous about market conditions or the economy. Bonds might help mitigate some of that risk while paying the client interest,” said Fox, adding that clients have many options for their purchases including individual municipal bond issues, mutual funds or ETFs.

Meanwhile, Jeff MacDonald, head of fixed income strategies at Fiduciary Trust International, says he is watching the election closely and the potential policy changes that could emerge based on both congressional and presidential results. Given the closeness of the race, however, he is not adjusting position portfolios in advance of any potential outcome.

MacDonald says he has no doubt that the sunsetting of the TCJA tax cuts would raise tax rates for high income earners, raising the appeal of tax-exempt income for that investor base. And from a fundamental perspective, he believes that a slowdown in new issue supply in municipals from the elevated levels of 2024 could combine with higher tax rates to create a positive technical demand story for the asset class.

Yet while he considers municipals to be competitive with other asset classes on an after-tax basis in a multi-asset portfolio, he also sees reasons to be cautious.

“The current Federal deficit is receiving a great deal of attention in this election season and both candidates’ policy platforms involve multi-trillion-

dollar deficits moving forward. Should the bond vigilantes decide to push back against this increased borrowing, it could usher in a period of higher yields and the lower bond prices that would accompany that adjustment," said MacDonald.

Similarly, Stash Graham, managing director & chief investment officer of Graham Capital Wealth Management, foresees increasing his allocation to tax-free municipal bonds. Still, he is waiting on a host of factors before making a move including the result of the Presidential Election, the yield curve's shape, credit quality, and the direction of interest rates are in general.

"We prefer to maintain our fixed income exposure on the short end of the curve. We do this to limit our interest rate or duration risk. We still believe present and future risks with the long end of the yield curve could rise. Municipal-related credit risks have been mitigated over the last few years, as they were significant beneficiaries of the federal government's COVID-era fiscal policies," said Graham, adding that he tends to focus more on general obligation bonds than revenue bonds back by hospitals.

With regard to the candidates, Graham agrees with the consensus that if former President Trump wins the Presidential Election, a material portion of the TCJA will be retained, especially those policies that promote investment by high-income and high-net-worth households. In his view, tax brackets for the high earners could see lower tax rates or a continuation of the current 37 percent tax rate depending on what the House of Representatives and Senate look like come next January, thus making tax-free municipal bonds slightly less attractive.

If Vice President Harris were to win the Presidential Election, however, Graham believes it would be fair to expect that a significant portion of the TCJA would sunset, and the highest tax bracket would likely return to its pre-TCJA rate of 39.6 percent.

"Naturally, it would be fair to expect more demand for Treasuries in this development," said Graham.

Matthew D. Liebman, founding partner & CEO at Amplius Wealth Advisors, is not increasing in his municipal bond allocation because, frankly, he does not see significant value in longer-term bonds currently.

"The front end of the municipal curve can become a bit crowded, so we are maintaining balance by also holding some short-duration taxable bonds," said Liebman.

Furthermore, he remains unconvinced that the TCJA will indeed sunset, believing a post-election deal is still possible. As a result, he is standing pat on his municipal bond exposure at this time.

Along similarly cautious lines, Don Bennyhoff, founder at fractional CIO for RIAs Bennyhoff & Co., believes "the factors affecting future muni

performance are too unpredictable and multifaceted" to get ahead of the Presidential election or Congressional decision on tax cuts.

Important Disclosures:

Municipal bonds are subject to availability and change in price. They are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax-free but other state and local taxes may apply. If sold prior to maturity, capital gains tax could apply.

Asset allocation does not ensure a profit or protect against a loss.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.

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