

Rhythmic volatility – SIFMA’s four week cycle

A tax-sensitive investor faces a never-ending choice of moving back and forth between taxable and tax-free products or committing to a tax-free product over time. There are benefits to both options, especially given the potential volatility in municipal rates. When stepping back to consider volatility over time it is easier to see the rhythm of the movements and the average change in rates.

What is SIFMA?

SIFMA (Securities Industry and Financial Markets Association) is a trade association for broker-dealers, investment banks and asset managers that serves as an industry coordinating body advocating for efficient market operations and more. “SIFMA” is used to refer to the organization but is more colloquially used by market participants when referring to the SIFMA Municipal Swap Index (MUNIPSA).

MUNIPSA is the core municipal rate used by tax-free investors. It is maintained by Bloomberg and is a 7-day high-grade index generally made up of hundreds of tax-exempt variable rate demand notes (VRDNs). Bloomberg calculates the index weekly and releases it on Wednesdays at 4 pm Eastern Time.

Within the municipal markets, MUNIPSA is used as the main benchmark variable rate for other transactions. For example, VRDNs might be issued at MUNIPSA plus 30 basis points and reset weekly as the index changes.



What is a VRDN?

VRDNs are municipal bonds generally issued by state and local governments as long-term bonds with final maturities that can exceed 20 years. However, they can have short-term puts or tender provisions, exercisable by the bondholder, with rates that reset daily, weekly or monthly based on a market rate. This reset feature makes them eligible investments for money market portfolios. VRDNs are commonly accepted as the core short-term investment instrument within municipal markets.

Rhythmic volatility

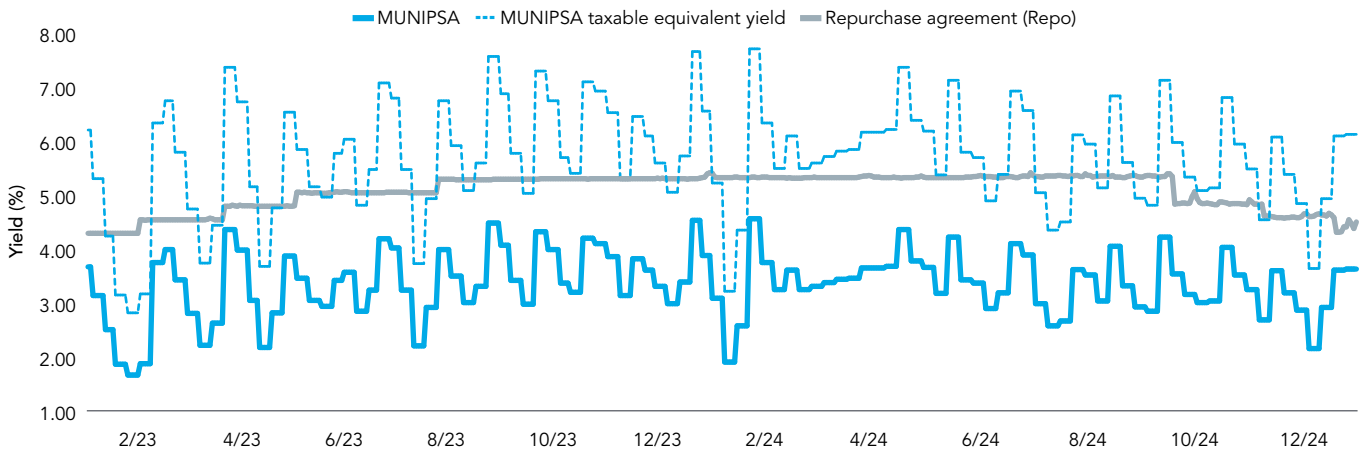
MUNIPSA fluctuates with what can seem like dramatic swings if you are not familiar with the pattern. In 2024, MUNIPSA yield peaked at 4.55%, bottomed at 1.90% and had an average rate of 3.35%.* This volatility can mainly be attributed to the dynamic relationship between VRDN supply and demand.

VRDN issuance has been low over the past several years as issuers have favored long-term debt because rates have been compelling to issuers. Furthermore, existing issuance was often insufficient to meet investor needs, so supply overall has been consistently low.

Demand for VRDNs, however, ebbs and flows and has consistently outweighed supply in recent years. A few key factors that influence demand are periods of strong seasonal reinvestment, typically in January and July; investor’s monthly cash flow patterns, generally investing early in the month then gradually redeeming; and ongoing individual after-tax valuations and movements by tax-sensitive investors. Given the current rate environment, demand has been especially high due to the attractiveness of money market portfolios in general.

This supply/demand relationship has a strong influence on municipal rates at the short end of the yield curve. When money flows in at the start of a month, demand increases and rates begin to decline which leads to outflows and rates rising. This can lead to frustrating fluctuations week to week, but if you look at the rate over time, you can begin to see a pattern that may provide some comfort.

MUNIPSA vs Repo (a taxable alternative)



Source: Bloomberg. As of 12/31/24.

Past performance is no guarantee of future results. For illustrative purposes and not representative of any specific investment. Taxable equivalent yield is based on 37% max individual federal tax rate plus 3.8% ACA tax.

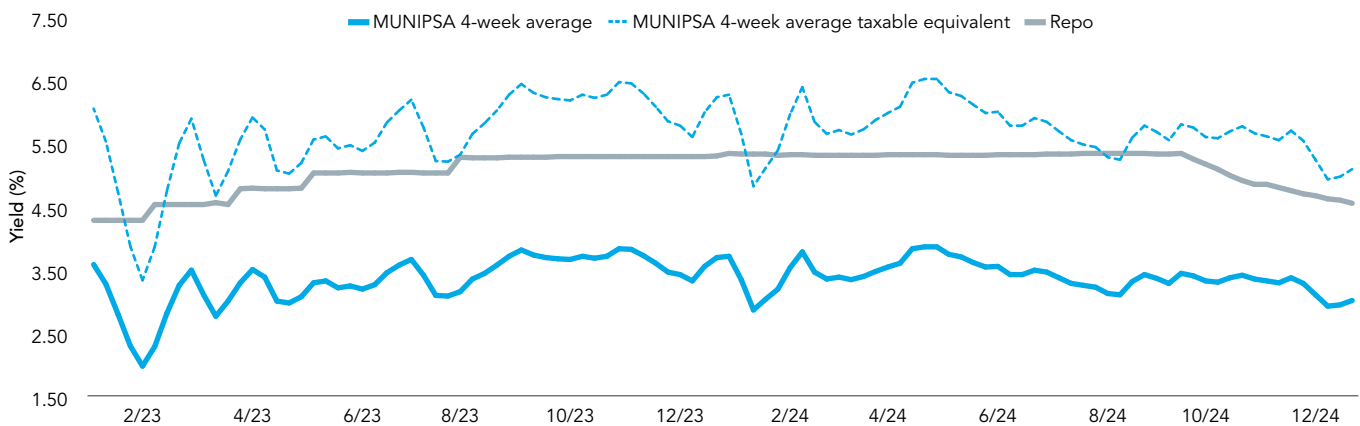
The graph above shows MUNIPSA rates since January of 2023. The pattern is clear, although not perfect, and there is no guarantee it will continue going forward, but it shows that the swings of 2023 and 2024 were not as unpredictable as they may have felt at the time.

We believe this pattern underscores the value of looking at a four week average as opposed to the current week's rate when making investment decisions.

The four week average can better represent potential outcomes for investors

It can be difficult to time entry and exit from the market when making decisions week to week. It may make more sense for investors to take a longer view and consider what the four week average MUNIPSA rate looks like. This calculation provides insight into what a portfolio may see over time if it remains invested throughout the week to week volatility. For example, the graph below shows that the 4-week average MUNIPSA taxable equivalent yield as of 12/25/24 was 5.09% compared to a 4.40% yield from Repo, an alternative taxable investment instrument.

4-week average: MUNIPSA vs Repo (a taxable alternative)



Source: Bloomberg. As of 12/31/24.

Past performance is no guarantee of future results. For illustrative purposes and not representative of any specific investment. Taxable equivalent yield is based on 37% max individual federal tax rate plus 3.8% ACA tax.

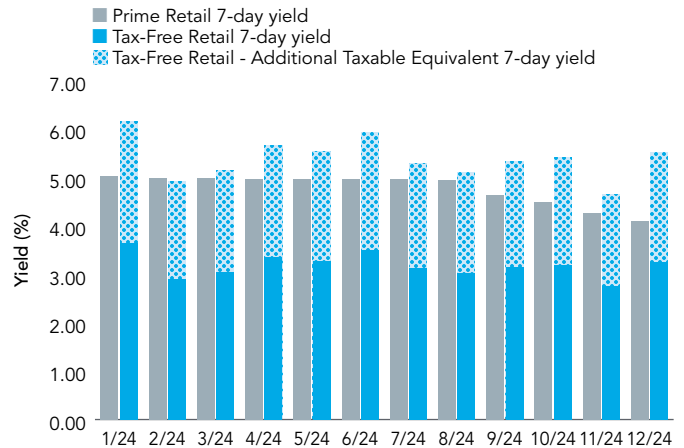
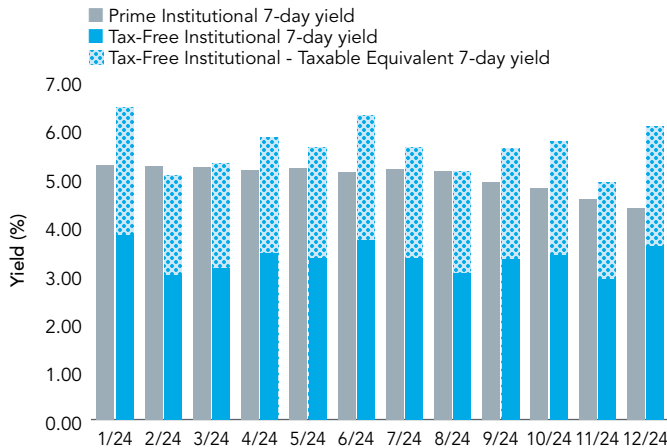
Municipal versus prime money market fund rates

Despite the volatility in municipal rates, when you look at the 7-day yields at month end iMoneyNet data shows that in 2024 taxable equivalent municipal yields were higher than prime yields on both the retail and institutional side almost every month.

Money market yields: Taxable equivalent municipal yields outperformed prime yields at month end 10 and 11 of 12 months respectively

iMoneyNet Institutional yields

iMoneyNet Retail yields



Source: iMoneyNet Analyzer as of 12/31/24.

Past performance is no guarantee of future results. For illustrative purposes and not representative of any specific investment.

Taxable equivalent yield is based on 37% max individual federal tax rate plus 3.8% ACA tax.

Looking ahead

As the Federal Reserve lowers the target range of the federal funds rate, we expect VRDN issuance to increase since there will likely be a larger spread in the yield curve providing more incentive for issuers. This could lead to municipal money market portfolios remaining attractive in after-tax valuations even if rates overall decline.

Our commitment to municipal investors

As one of the largest investment managers and a pioneer in liquidity management for over 50 years, we are committed to serving our clients. Our municipal liquidity markets and short-term municipal bonds team consists of four portfolio managers, four analysts and three traders dedicated to municipal investing and averaging 25 years of industry experience. This core team is supported by our broader fixed income and liquidity teams consisting of 145 investment professionals overall. We use our decades of experience and unwavering client focus to ruthlessly vet investments and aim to provide sound liquidity management through all market environments.

To learn more, please call our Liquidity Management Desk at 1-888-295-4810 or find your representative at [Federated Hermes’ Liquidity Management Resource Center Contact Us page](#).

*Source: Bloomberg. As of 12/31/24.

Bond prices are sensitive to changes in interest rates and a rise in interest rates can cause a decline in their prices.

This should not be construed as a tax recommendation. Please consult your tax professional for more information.

Income from tax-free funds may be subject to the Federal alternative minimum tax and state and local taxes.

Indexes are unmanaged and investments cannot be made in an index.

Repurchase Agreement: Agreement between a seller and a buyer, usually of US government securities, whereby the seller agrees to repurchase the securities at an agreed upon price and, usually, at a stated time. Repos are widely used both as a money market investment vehicle and as an instrument of Federal Reserve monetary policy.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

Investors should carefully consider the fund’s investment objectives, risks, charges and expenses before investing. To obtain a summary prospectus or prospectus containing this and other information, contact us or view the prospectus provided on FederatedHermes.com/us. Please carefully read the summary prospectus or prospectus before investing.

Retail MMFs

You could lose money by investing in the fund. Although the fund seeks to preserve the value of your investment at \$1.00 per share, it cannot guarantee it will do so. The fund may impose a fee upon sale of your shares. An investment in the fund is not a bank account and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund’s sponsor is not required to reimburse the fund for losses, and you should not expect that the sponsor will provide financial support to the fund at any time, including during periods of market stress.

Institutional MMFs

You could lose money by investing in the fund. Because the share price of the fund will fluctuate, when you sell your shares, they may be worth more or less than what you originally paid for them. The fund may impose a fee upon sale of your shares. The fund generally must impose a fee when net sales of fund shares exceed certain levels. An investment in the fund is not a bank account and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. The fund’s sponsor is not required to reimburse the fund for losses, and you should not expect that the sponsor will provide financial support to the fund at any time, including during periods of market stress.