

# MUNICIPAL BONDS: A BRIGHT SPOT IN TODAY'S UNCERTAIN MARKETS

2018 proved to be a solid year for municipal bonds, as they outperformed US Treasuries by 42 basis points (0.42%), as of December 31, 2018.<sup>1</sup> What's more—munis tended to have less volatility than what we've seen in other parts of the market. Although there can be no guarantee of future outperformance, here are the key reasons why we believe munis will likely continue to be a bright spot in the near future.

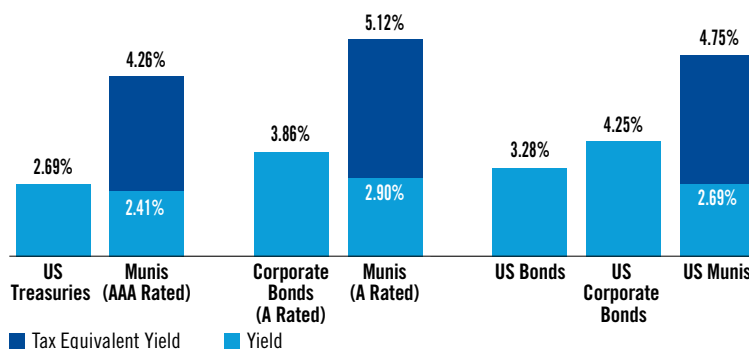
## Four Reasons Why Municipal Bonds Make Sense Now

### 1 Higher Yields

Municipal bonds provided a higher tax-equivalent yield than most other types of bonds, as of December 31, 2018. Given current tax rates, the tax-free benefit of munis makes them very attractive.

#### Muni Yields Have Remained Strong<sup>2,3</sup>

Yield-to-Worst as of December 31, 2018



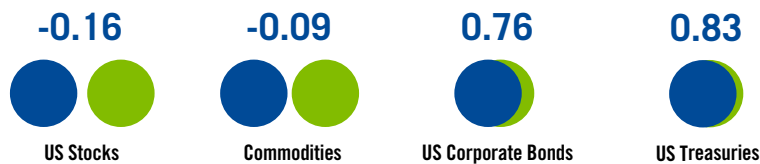
Munis have provided more income recently than other bonds

### 2 Low Correlation

The negative correlation that munis have had with US stocks may make them a solid addition to a well-diversified portfolio.

#### Muni Correlations with Various Asset Classes<sup>4</sup>

Five-Year Period Ending December 31, 2018



Munis may add an additional layer of diversification

Correlation is the statistical measure of the degree to which the movements of two variables are related; 1 = perfect positive correlation, 0 = no correlation, and -1 = perfect negative correlation.

### 3 Lower Default Rates

Aside from the few cases of potential defaults focused on by the media, munis have historically had a very low default rate compared to other fixed-income investments.

#### Average Cumulative 10-Year Default Rates<sup>5</sup>

1970–2017

	Investment-Grade	Speculative-Grade	All Rated
Municipal Bonds	0.10%	7.58%	0.17%
US Corporate Bonds	2.32%	29.33%	10.24%

Munis' historically lower default rate may mean less risk than other types of bonds

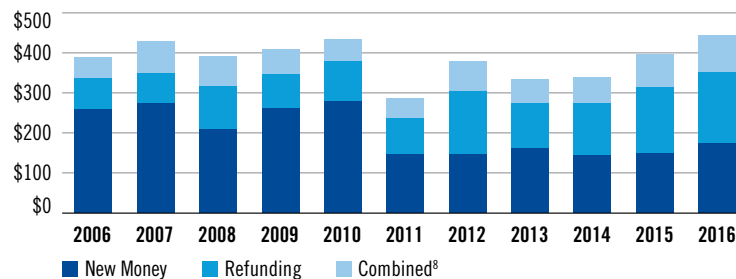
The charts above are for illustrative purposes only. They do not represent the past or future performance of any Franklin Templeton fund. For current performance of any Franklin Templeton fund, please call us at (800) DIAL BEN/342-5236. The results depicted do not reflect the fees or charges an investor would incur with an investment in a municipal bond fund. If such costs were included, the performance shown would have been lower. Past performance does not guarantee future results. Treasuries, if held to maturity, offer a fixed rate of return and fixed principal value; interest payments and principal are guaranteed.

## 4 Low Supply

Muni supply has been constrained, as shown by the dark blue bars on the right. And supply has remained low through at least 2016.<sup>6</sup>

### US Municipal Bond Issuance<sup>7</sup>

2006–2016 (in Billions)



Low supply should help buoy muni prices

## Invest with a Tax-Free Leader

### Experience

Franklin has managed tax-free income funds since 1977. Today, we're one of the largest municipal bond fund managers in the nation,<sup>9</sup> and have more than \$61 billion in municipal bond assets under management.<sup>10</sup>

### Strength

Our large tax-free investment management team—30 municipal bond investment professionals with an average of 22 years of financial industry experience<sup>10</sup>—has the experience to identify opportunities and risk indications others might miss. We believe this is critical given the vast size of the municipal bond market, with more than 118,000 municipal issuers and nearly one million separate bond issues outstanding.<sup>11</sup>

### Opportunity

To help meet your investment needs, we offer over 29 tax-free funds, including national and state-specific, investment grade and high-yield, and long-, intermediate- and limited-term funds. Franklin tax-free income funds seek to provide monthly income exempt from regular federal and, depending on the fund and the investor's state of residency, state and local income taxes.<sup>3</sup>

**What Are the Risks? All investments involve risks, including possible loss of principal.** Municipal bonds are affected by interest rate movements. Municipal bond prices, and thus, a tax-free income fund's share price, generally move in the opposite direction of interest rates. As the prices of the municipal bonds in a fund portfolio adjust to a rise in interest rates, the fund's share price may decline. Changes in the credit rating of a bond, or in the credit rating or financial strength of a bond's issuer, insurer or guarantor, may affect the bond's value. There is no guarantee that after-tax returns of municipal bonds will be greater than those of taxable investments. For investors subject to the alternative minimum tax, a small portion of dividends of a tax-free income portfolio may be taxable. Distributions of capital gains are generally taxable. Diversification does not guarantee a profit or protect against a loss.

*Investors should carefully consider a fund's investment goals, risks, charges and expenses before investing. To obtain a summary prospectus and/or prospectus, which contains this and other information, talk to your financial advisor, call us at (800) DIAL BEN/342-5236 or visit [franklintempleton.com](http://franklintempleton.com). Please carefully read a prospectus before you invest or send money.*

1. Source: 2018 Morningstar. US Treasuries are represented by the US 10-year Treasury Bond. US Munis are represented by the Bloomberg Barclays Municipal Bond Index. Indexes are unmanaged and one cannot invest directly in an index. See [www.franklintempletondatasources.com](http://www.franklintempletondatasources.com) for additional data provider information.
2. Source: US Treasuries are represented by 2018 Morningstar (BofA Merrill Lynch Current US Treasury (10-Y) Index, municipal bonds are represented by Bloomberg Barclays Municipal Bond (AAA) Index, corporate bonds are represented by the Bloomberg Barclays US Aggregate Corporate (A) Index, municipal bonds (A rated) are represented by Bloomberg Barclays Municipal Bond (A) Index, US bonds are represented by Bloomberg Barclays US Aggregate Index, US corporate bonds are represented by BofA Merrill Lynch US Corporate Index. US munis are represented by Bloomberg Barclays Municipal Bond Index. Indexes are unmanaged and one cannot invest directly in an index. See [www.franklintempletondatasources.com](http://www.franklintempletondatasources.com) for additional data provider information. The yield to worst (YTW) is the lowest potential yield that can be received on a bond without the issuer actually defaulting. The tax-equivalent return is used by investors to compare taxable and tax-exempt securities after accounting for federal taxes (excluding AMT). For this comparison, we used the maximum tax rate of 37%, plus the 3.8% tax from the Affordable Care Act.
3. For investors subject to the alternative minimum tax, a small portion of fund dividends may be taxable. Distributions of capital gains are generally taxable.
4. Municipal Bonds are represented by Bloomberg Barclays Municipal Bond (AAA) Index, US Stocks are represented by S&P 500 Index, commodities are represented by Bloomberg Commodity Index, US Corporate Bonds are represented by BofA Merrill Lynch US Corporate Index, US Treasuries are represented by BofA Merrill Lynch Current US Treasury (10-Y) Index.
5. Source: Moody's Corporation. Most recent annual data available. A speculative-grade bond has a rating of lower than Baa, an investment-grade bond has a rating of Baa or higher.
6. Source: JP Morgan. Most recent data available.
7. Source: Bond Buyer. Refunding is a refinancing of existing "refunded" bonds with new "refunding" bonds.
8. Combination issuance indicates that a deal contains a combination of both new and refunding issuance.
9. Source: Morningstar Direct as of 12/31/2018. Based on long-term municipal bond fund assets.
10. As of 12/31/2018. Municipal bond assets under management figure includes US retail municipal bond fund assets and separately managed accounts.
11. Source: Bloomberg as of 10/23/2018. Based on the most recent data available.



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