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Contrarian Barclays Says Munis Are Not Headed for a Strong Summer.

- **Very supportive supply/demand technicals trumped by valuations**
- **Ratios are 2+ standard deviations rich, close to 5-year lows**

While many on Wall Street expect a heady summer for state and local debt, Barclays analysts are making a different call.

Despite forecasts for negative net issuance amid steady demand, the municipal market is unlikely to see a strong performance over the summer, according to Barclays municipal analyst team led by Mikhail Foux. Valuation is a better indicator of where the securities' performance is headed, they wrote in a June 2 note to investors.

Municipal bonds current yields relative to U.S. Treasuries mean "there is very little value in the front-end but, with 30-year ratios already in mid-90s, the long end is hardly attractive." Barclays added that, "as it stands, muni ratios are 2+ standard deviations rich compared with their three-month average, and are close to five-year lows."

"Given that, currently, muni ratios are moving close to multi-year lows, we do not foresee strong performance from the asset class over the coming months, despite supportive technicals," the strategists wrote in the note.

The view differs from other strategists who expect municipal bonds to continue to strengthen as demand outpaces supply and cash-rich investors have more money to deploy. The Barclays analysts wrote they expect net issuance to be a negative $25 to $35 billion this summer, near the levels other analysts estimate, but that a similar amount of negative net issuance in 2014 did not translate into lower ratios that year. They also noted that negative net issuance is not uncommon for the summer season.

"We are unlikely to see a major selloff any time soon, but, in our view, ratios might end up higher by the end of August."

Bloomberg

by Rebecca Spalding

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