
[Foreign Cash Fleeing Low Yields Flows Into U.S. Muni Bonds.](#)

- **Overseas holdings of state, local bonds hits new record high**
- **Even low payouts look good against Japanese, German bonds**

The era of record low interest rates around the world has unleashed an unprecedented tide of overseas cash for U.S. municipal-bond fund managers like Gregory Gizzi, who hopscotched around Asia this month courting would-be investors.

"We've been witnessing a big increase of interest," said Gizzi, a senior portfolio manager with Macquarie Investment Management, which holds $8.9 billion of municipal debt.

It's showing no signs of pulling back. Foreign investors increased their holdings of debt issued by states, cities and local agencies by $3.1 billion during the second quarter to $98.6 billion, an all-time high and more than triple what it was a little over a decade ago, according to Federal Reserve data. They've added to their holdings every quarter for the past five years.

The globalization of the municipal market, still largely a low-yielding haven for risk-averse Americans seeking tax-exempt income, has helped increase demand for the securities. With the pace of borrowing slowing this year and money still flowing in, state and local bond yields are lower now than they were in January. Even after the market's recent slide on increased speculation the Federal Reserve will raise interest rates in December, municipal debt has returned 4.8 percent this year, more than twice as much as Treasuries, according to Bloomberg Barclays indexes.

On Thursday afternoon in New York, 10-year benchmark bonds were yielding 1.98 percent, according to Bloomberg indexes, about seven basis points higher than where they stood at the beginning of the week. Even with the rise in yields, that's still about four times what similar German bonds are paying. In Japan, yields barely exceed zero.

The allure for overseas buyers is even larger when it comes to taxable municipal debt, which carry higher yields than corporate debt. A 10-year Illinois bond with payments that are subject to the U.S. income tax yields about 1.3 percentage point more than those issued by Ford Motor Co.

State and local bonds are also carry far less risk than other securities: The 10-year default rate for municipal bonds is only 0.07 percent compared with 10.3 percent for corporate bonds issued in the U.S. and abroad, according to Moody's Investors Service.

"These taxable munis are the cheapest thing around if you're an international investor right now," said Kyle Gerberding, director of trading at Atlanta-based Asset Preservation Advisors, which has more than $3 billion invested in tax-exempt and taxable municipal bonds.

Mizuho Securities' U.S. strategist, Tetsuo "Harry" Ishihara, says he still receives calls from Japanese clients interested in investing after he published research about the sector last year. Ishihara said the municipal market, once obscure in Japan, has gained enough traction that many firms now market them to customers.

“The good thing about Japanese investors is once they like you, they are very loyal,” he said in a telephone interview.

“When they know their money is going to bridges and schools, they love that,” he said. “It’s very deeply indebted in their training from day one. You have a social role.”

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