A Wall Street Haven for Democrats Has Reason to Cheer a Blue Wave.

- **Republican House win seen fueling another potential sell-off**
- **Another round of tax cutting could put pressure on rates**

There's one area of Wall Street where you can find a bit of blue in what's typically seen as a sea of red: public finance.

But the bankers and mutual fund managers who work in the $3.9 trillion municipal-bond market have professional reasons to root for Democrats Tuesday regardless of their political views. If Republicans defy polls and keep control of the U.S. House of Representatives, analysts at BlackRock Inc., Barclays Plc and Citigroup Inc. have predicted that bond prices may tumble on anticipation that Republicans will push through another round of tax cuts just as the Federal Reserve is raising interest rates to cool down the economy.

"The GOP retaining power in the House, even by the slimmest of margins, is bearish," said Vikram Rai, head of Citigroup's municipal strategy group. "I would expect you could see a selloff in the fixed-income markets altogether."

The Congressional elections come as bonds are under pressure because the economy continues to expand at a solid pace, holding unemployment at a near half-century low. The steady drumbeat of strong economic data has sent the municipal securities market to a two-month losing streak, causing investors to pull funds from state and local government debt funds for the past six weeks.

The pressure on the market would likely be worsened by another round of tax-cuts, which would reduce demand for tax-free securities and put more pressure on the Fed to raise rates by further fanning the economy. Last year's corporate tax cut also dealt a blow to Wall Street underwriters by doing away with the tax exemption on bonds sold for a key type of refinancing, helping spur a drop in new debt sales this year. To offset the cost of deeper reductions, a Republican-led Congress could chip away at the market's subsidies even more.

Reinforcing Convictions

"Equity people are driven by: lower taxes mean higher earnings per share," said Craig Brandon, co-director of municipal investments at Eaton Vance. "If you're a fixed-income person, higher deficits might not necessarily be so good for Treasuries, state governments."

That may be reinforcing convictions in what's already a corner of Wall Street where Democratic politics mix well with business. Tax cuts at the local level tend to not be popular with bondholders, given that a smaller revenue stream increases their risk. And for securities firms, the big cities and states, such as New York and California that are a major source of new debt deals, skew Democratic.

Bankers tend to "see the view point of the people they represent — the larger issuers who tend to be Democratic," said Richard Ciccarone, head of Merritt Research Services, who has worked in the municipal bond industry for more than three decades.

Banks' public finance departments frequently include former Democratic officials. Chicago's chief financial officer, Carole Brown, previously worked for Barclays, and a current candidate for mayor, Bill Daley, once worked for JPMorgan Chase & Co. Henry Cisneros, who led the U.S. Department of Housing and Urban Development under President Bill Clinton, and William Thompson, Jr., former New York City comptroller, are part of the leadership team at municipal-bond investment bank Siebert Cisneros Shank & Co.

Dominant Banks

But public officials say politics doesn't determine which banks underwrite their bonds — a business that's come to be dominated by Bank of America Corp., Citigroup and JPMorgan — and bankers are banned from making political donations to their clients under securities rules. Tim Schaefer, California's deputy treasurer, said political connections don't play a role in debt deals.

"It doesn't come up in my work at all," he said.

Still, the municipal-bond business stands to benefit from a Democratic advance. In Washington, Democrats are planning to push for major transportation and infrastructure plans if they win the House, picking up on a stated priority of President Donald Trump's that took a back seat to last year's tax cuts. Such a plan could involve subsidized bond sales by states and cities, as were included in the economic stimulus plan passed under former President Barack Obama.

State elections have implications as well, with Democrats seeking to chip away at the majority that Republicans have held in governors' offices since the Tea Party wave in 2010. In Illinois, Democrat J.B. Pritzker is the favored winner in his bid to unseat Governor Bruce Rauner, a Republican whose term was marked by battles with the Democrat-led legislature over his plans for turning around the state's finances.

Democrat Gretchen Whitmer, who is running for governor of Michigan, has made fixing roads and bridges a part of her platform, saying she would go to voters for a bond measure if the state legislature doesn't "sufficiently fund" an infrastructure bank. In Ohio, Democrat Richard Cordray is in favor of seeking voter approval for an infrastructure program financed by debt.

"If you're a banker, you want to do deals, you want to do projects," said Joseph Krist, a partner at research firm Court Street Group, who previously worked at UBS AG and is a Democrat. "It's kind of what we do."

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