
‘No Bold Bets’ for Muni-Bond Managers Stung by Trump's Victory.

- **Trump’s surprise win caused bond market to fall on rate fears**
- **Polls predict Democratic House, but they could be wrong again**

People who work in the municipal-bond industry describe November 2016 as “awful,” “like staring down the bottom of a bottomless well,” and simply “extreme.”

Now, they’re preparing for the prospect of another sell-off if Republicans score another surprise upset on Election Day and keep control of the U.S. House of Representatives. Such a scenario could cause bond prices to 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 pace of the economy. President Donald Trump’s 2016 win pushed the municipal market to its biggest monthly loss since the recession.

“You have to take everything with a giant grain of salt,” said Nicholas Foley, senior portfolio manager at Segall Bryant & Hamill LLC, who said he was prepared for an early morning on Wednesday if there is a surprise win by the GOP.

The firm has reduced exposure to long-dated hospital bonds, which could be hit hard if the Republicans keep control of Congress and make another effort to repeal the Affordable Care Act. At the same time, the firm is trying to make sure that it has “proper exposure” to municipals to benefit from Democrats winning control of the House, which could cause state and local debt to gain by diminishing the chances of deeper tax cuts or a rollback to the tax exemption for the income from the securities.

“There’s a lot of uncertainty,” said Foley, who compared the November 2016 sell-off to the bottomless well. “You can feel it in the market.”

Given the chance of the polls being off, as they were in 2016 and in the U.K. Brexit vote, Vikram Rai, head of Citigroup’s municipal strategy group, is telling clients to be cautious.

GOP control of Congress would be “material” because of the likelihood of a second tax-cutting round, which could threaten the tax-exemption on municipal bonds as lawmakers look to raise revenue, Rai said.

The 2016 elections and the tax law changes enacted late last year have ignited increased interest in federal politics from what’s typically viewed as a buy-and-hold asset class. Among other steps, the Trump tax cuts reduced demand for bonds from corporations and limited the state and local tax deduction, which caused some residents of high-cost states to invest in municipal bonds to drive down their taxable income.

“I don’t remember ever a time when we talked to clients more about it,” said Tom Casey, a senior portfolio manager at Standish, a division of BNY Mellon Asset Management North America. While

Casey said he’s still focused on technical factors like supply and demand and what it means for the asset class, he said he’s reading and talking about politics much more than usual in his career.

“We’re clearly in different times than we have been in a long while,” Casey said.

The midterms are arriving as state and local debt is headed for a 1.3 percent loss this year as interest rates tick up, the first drop since 2013. Investors are starting to pull their money out of municipal-bond mutual funds, with the funds seeing six weeks of outflows. With elections this week, supply has dwindled to just about $6 billion in bonds this week.

James Iselin, a managing director at Neuberger Berman, said he’s been more cautious on the high valuation of state and local debt in general, and he’s not making any big calls ahead of election night. “There’s so many unpredictable outcomes, it’s not a time to step out with any bold bets,” he said.

Sweta Singh, a portfolio manager at Wilkins Investment Counsel Inc., said the firm’s “bottom-up” analysis of credits it owns makes it comfortable with its municipal holdings regardless of what happens in Washington. It’s still too early to forecast the way policies could shift, she said.

“For it to percolate to an actionable item, there’s a gestation period and a time-lag,” she said.

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By Amanda Albright

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