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Munis Cheapest to Treasuries Since March Amid Biggest '14 Exodus.

Municipal bonds are the cheapest in four months relative to Treasuries as speculation that debt from Puerto Rico will default spurs the biggest exodus from local-debt mutual funds since January.

Benchmark 10-year munis yield about 2.44 percent, according to data compiled by Bloomberg. The interest rate on 10-year Treasuries, by comparison, is 2.51 percent. That makes the ratio of the yields about 97 percent, the highest since March 13, signaling that state and local debt has cheapened on a relative basis.

Individuals yanked $790 million from muni mutual funds in the week through July 9, with the highest outflows from funds focused on long-dated and high-yield debt, Lipper US Fund Flows data show. With supply next week set to tally about $4.7 billion, compared with the 2014 average of $5.4 billion, investors may be lured by the relatively higher tax-free yields, said Dan Toboja at Ziegler Capital Markets.

"As munis begin to cheapen up and Treasuries stay stable or rally, at some point people are going to say munis are a good relative value," said Toboja, senior vice president of muni trading at Chicago-based Ziegler.

The $3.7 trillion municipal market is off to its strongest annual start since 2009 because bond sales are 16 percent off last year's pace. Demand has also benefited as some individuals faced levies on bond interest payments as much as 24 percent higher than in 2012. The 10-year benchmark muni yield is equivalent to 4.31 percent taxable for top earners.

On July 1, Moody's Investors Service cut Puerto Rico's rating to B2, five steps below investment grade, because of a new law allowing some public corporations to restructure their debt. The island and its agencies have $73 billion of debt, or about 2 percent of the entire market.

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