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Munis Still Cheap as Best Rally in a Year Can't Match Treasuries.

The \$3.6 trillion municipal market is rallying the most in 12 months. It still looks cheap compared with Treasuries.

Benchmark 10-year muni yields have fallen 0.28 percentage point in January to a 20-month low of 1.83 percent, data compiled by Bloomberg show. If that decline holds, it would be the steepest monthly drop since January 2014.

While muni interest rates are the lowest since May 2013, the debt is close to the cheapest since December 2013 relative to federal debt. The ratio of interest rates on state and local bonds relative to Treasuries touched 106 percent on Thursday in New York. That signals tax-free bonds have weakened relative to their federal counterparts, which are on pace for the strongest month since August 2011.

"Despite the performance in munis over the last 10 days, it's lagged Treasuries," said Adam Buchanan, vice president of sales and trading at Ziegler, a broker-dealer in Chicago. "There's still room to run here."

The municipal market rallied in 2014 by the most in three years. Analysts including Michael Zexas at Morgan Stanley predicted smaller gains in 2015 amid rising interest rates on Treasuries. Instead, yields plunged anew this week after Switzerland's unexpected decision to abandon its currency cap drove investors to the safest assets.

Resurgent Rally

At 1.75 percent, 10-year Treasury yields are close to the lowest since May 2013. The Treasury market has gained 2.28 percent this month, compared with 1.45 percent for munis, Bank of America Merrill Lynch data show. The local-government market hasn't earned that much since rallying 2.27 percent in January 2014.

Individuals poured \$1.34 billion into muni mutual funds in the week through Jan. 7, the most in two years, Lipper US Fund Flows data show. They added \$689 million in the week through Jan. 14.

The muni-Treasury ratio has historically been below 100 percent because interest on state and local debt is tax-exempt. The 1.83 percent yield on AAA munis is equivalent to 3.03 percent taxable for top earners.

Investors looking to capitalize on the relative cheapness have the chance next week. States and cities plan \$8.8 billion of bond sales next week, the most in about a month. U.S. bond markets are closed Jan. 19 for Martin Luther King Jr. Day.

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