# Bond Case Briefs

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## Local Debt Trails Treasuries on January Sales Surge: Muni Credit.

(Bloomberg) — Even as the $3.6 trillion municipal market heads for its biggest monthly gain in a year, it still can't keep up with surging Treasuries.

Munis have advanced 1.6 percent in January, while federal debt has earned 2.6 percent, according to Bank of America Merrill Lynch data. With borrowing costs diving amid signs the global economy is slowing, localities are scheduled to sell about $29 billion of bonds this month, which would be the busiest January in five years, data compiled by Bloomberg show.

Money is flowing into tax-exempt mutual funds at almost double the pace of the past year. Yet the spate of borrowing, powered in part by communities refinancing higher-cost obligations, signals that munis may struggle to repeat a 2014 performance in which they beat other areas of fixed income.

The sales calendar "adds a little pressure," said Alan Schankel, a managing director at Janney Montgomery Scott LLC in Philadelphia. "On the other hand, fund flows and demand metrics have been pretty strong throughout the month."

**Sales Headwind**

Rising issuance presents another headwind in a year when the consensus view is that interest rates will climb and depress munis' performance after the bonds rallied 9.8 percent last year, the most since 2011. The 2014 gain beat advances of 6 percent for Treasuries and 7.5 percent for corporate debt.

Returns on state and city debt will probably be less than in 2014, even as munis may outperform Treasuries, Schankel said.

Wall Street analysts predict a growing economy will push interest rates up. Yields on 30-year Treasuries will rise about 1.1 percentage points to 3.4 percent a year from now, according to the median forecast of 42 analysts in a Bloomberg survey.

The opposite happened on Wednesday in New York: Treasuries surged after the Federal Reserve maintained a pledge to be "patient" on raising interest rates. It cited international risks to the economy while boosting its assessment for the U.S. Yields on 30-year Treasuries set a record low of 2.27 percent.

**Dust Cloud**

"Strong Treasury rallies often leave munis in the dust initially," said James Dearborn, head of munis in Boston at Columbia Management Investment Advisers, which oversees about $30 billion in local debt. "I'm taking comfort from the fact, in spite of all the supply, you're still seeing deals get done and oversubscribed."

Benchmark 10-year muni yields have dropped a quarter-percentage point this month to 1.86 percent, data compiled by Bloomberg show. Yields touched 1.81 on Jan. 21, the lowest since May 2013. Bonds' yields and prices move in the opposite direction.

Even with the gains, judging by relative yields, munis are the cheapest in more than a year compared with Treasuries.

Benchmark 10-year muni yields are about 105 percent of the level on similar-maturity Treasuries. The ratio, a measure of relative value between the asset classes, is close to the highest since October 2013. The figure is typically below 100 percent because investors are willing to accept lower interest rates in exchange for munis' tax-free income.

**Attraction Rules**

"For certain parts of the curve, munis are an extremely attractive asset class," said Gary Pollack, who manages $12 billion as head of fixed-income trading at Deutsche Bank AG's Private Wealth Management unit in New York.

The appeal of tax-exempt interest has only climbed after investors last year faced tax bills that included federal increases that took effect in 2013. The top marginal rate of 39.6 percent is the highest since 2000.
The 1.86 percent yield on benchmark 10-year munis is equivalent to about 3.1 percent taxable for the highest earners.

Investors added about $1 billion to mutual funds that target munis in the week ended Jan. 21, compared with a one-year average increase of about $600 million, according to Investment Company Institute data compiled by Bloomberg.

"With tax brackets where they are, it makes the math pretty easy to justify buying munis," said Patrick Morrissey, who helps oversee $3.3 billion of fixed income at Great Lakes Advisors LLC in Chicago.

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by Elizabeth Campbell

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To contact the reporter on this story: Elizabeth Campbell in Chicago at ecampbell14@bloomberg.net

To contact the editors responsible for this story: Stephen Merelman at smerelman@bloomberg.net Mark Tannenbaum, Mark Schoifet