# **Bond Case Briefs**

Municipal Finance Law Since 1971

## Record Rally Poised to End With Yields at 2015 Peak: Muni Credit

(Bloomberg) — The \$3.5 trillion municipal market's record 13-month rally is poised to end as fixed-income assets slide and localities sell the most debt since 2007.

Munis have lost 1.2 percent this month, and are headed for the first monthly decline since December 2013, Bank of America Merrill Lynch data show. The streak of gains, the longest since the data began in 1989, drove the local-debt market to a 9.8 percent return in 2014.

Treasuries and corporate bonds are also posting February losses after a strengthening labor market signaled the U.S. economy is gaining momentum. State and city obligations face the added headwind of surging issuance from refinancing: Municipalities have sold about \$46 billion of securities this year through Feb. 13, the busiest annual start since 2007, data compiled by Bloomberg show.

The borrowing jump "seems to be probably the predominant factor" behind the declines, said Kevin Ramundo, a fund manager who helps oversee \$30 billion in munis at Fidelity Investments in Merrimack, New Hampshire. "We certainly didn't think that the returns that we saw in 2014 were likely to be repeated in 2015."

#### **Refunding Pace**

States and localities picked up the pace of refunding after interest rates fell to 20-month lows at the start of February. Yields on benchmark 10-year munis have since risen to about 2.1 percent, close to this year's high, from 1.78 percent on Feb. 2. Yields climbed after Labor Department data for January showed the biggest three-month jobs gain in 17 years.

Refinancings are set to account for about 42 percent of sales this week, Bloomberg data show. Scottsdale, Arizona, and Pennsylvania's Montgomery County Industrial Development Authority are among issuers refunding.

The leap in bond sales may increase issuance forecasts for 2015, according to Michael Zezas, chief muni strategist at Morgan Stanley. Offerings this year may exceed his December forecast of about \$354 billion, which would be 15 percent higher than in 2014 and end a four-year market contraction, he said.

"The upside in supply is pretty substantial," Zezas said at a Bond Buyer conference in New York on Wednesday. In addition to the flood of refinancings, the economic expansion has also strengthened local finances and made voters more open to debt sales for infrastructure, he said.

#### **Beating Treasuries**

While munis are on pace for a monthly loss, Treasuries and corporate debt have declined even more, by 2.1 percent and 1.6 percent, respectively.

Munis have benefited from demand for tax-free income, with the top federal income-tax rate at 39.6

percent as of last year, the highest level since 2000.

Even as munis outperform Treasuries in February, tax-free yields still exceed those on federal debt for 10-year maturities. The ratio of the yields, a measure of relative value between the two markets, is about 101 percent, where the six-year average is about 99 percent. The higher the figure, the cheaper munis are in comparison.

Munis remain "one of the cheaper asset classes," said Dan Heckman, a fixed-income strategist who helps oversee \$126 billion at U.S. Bank Wealth Management in Kansas City. "Fundamentally, most municipalities are doing well."

### Minutes' Signal

The reaction to Wednesday's release of minutes for the Federal Reserve's January meeting suggests municipalities have more room to refinance. Treasuries climbed as the minutes showed many policy makers favored keeping the overnight benchmark at virtually zero "for a longer time."

The Fed will raise its target, which it's held in a range of zero to 0.25 percent since 2008, as soon as the third quarter, according to the median forecast in a Bloomberg News survey.

The prospect for higher rates in 2015 means the tax-free market will struggle to match last year's performance, according to Zezas.

In his 2015 outlook, published in December, Zezas estimated munis will earn 1.14 percent this year. "I imagine you'll see much more modest returns than you had in 2014, and the path to get there is likely to be much more volatile," he said Wednesday.

Bloomberg Muni Credit

by Meenal Vamburkar and Brian Chappatta

February 18, 2015

To contact the reporters on this story: Meenal Vamburkar in New York at mvamburkar@bloomberg.net; Brian Chappatta in New York at bchappatta1@bloomberg.net

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

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com