
Munis Dodge Market Turmoil With Top 2015 Returns Among Assets.

For U.S. investors, the safe haven from the recent global financial turmoil might be in their own backyards.

The $3.6 trillion market for state and local government debt rallied in August, pushing this year's return to 1.1 percent, Bank of America Merrill Lynch data show. Among fixed-income assets, that matched Treasuries, the traditional financial refuge, and beat U.S. corporate bonds, which lost 0.5 percent. The Standard & Poor's 500 index is down 3.5 percent, the most since 2008, while commodities saw about 16 percent of their value disappear.

The returns underscore the calm in the municipal-bond market, where most of the securities are held by individuals seeking tax-free income instead of speculators betting on price swings.

"Munis certainly have been an area of relative tranquility," said Chris Alwine, head of municipals at Valley Forge, Pennsylvania-based Vanguard Group Inc., which oversees $147 billion of the debt. "We expect to see higher levels of volatility in the Treasury and credit markets, but munis have been removed from that and we expect it'll remain that way."

Volatility has surged in global financial markets since China's surprise devaluation of the yuan this month, which sparked speculation that policy makers may fail to prevent a steep slowdown in the world's second-largest economy. The S&P 500 tumbled 11 percent in the six trading days through Tuesday, only to pare the losses as stocks rallied for the rest of the week.

Benchmark 10-year muni yields, which move in the opposite direction as prices, have slid 0.09 percentage point over the last three weeks, according to data compiled by Bloomberg.

History suggests the gains could last. The 2.22 percent yield on 10-year AAA munis compares with 2.14 percent for similar Treasuries. The ratio of the two rates, now 104 percent, is above the 97-percent average over the past decade, signaling that state and local debt remains cheap in comparison.

"It looks like people are coming in, parking cash, and re-evaluating what their asset allocation has been," said Rick Taormina, head of municipal strategies at J.P. Morgan Asset Management, which oversees $56 billion in state and local debt. "You see folks in these times go into safety."

In many ways, the odds were stacked against a rally.

Unlike last year, when investors poured cash into funds focused on munis, individuals yanked money from them for 11 straight weeks through July, the longest stretch in 18 months, Lipper US Fund Flows data show. The exodus came as states and cities were flooding the market with new bonds at the fastest pace in at least 12 years, seeking to borrow before the Federal Reserve raises interest rates.

The market was also put on edge by pockets of distress. Saddled with $72 billion of debt, Puerto Rico is on the verge of trying to force unprecedented losses on investors and defaulted for the first time this month.

Chicago’s bond prices have tumbled since it lost its investment grade from Moody’s Investors Service in May, the result of soaring bills to the workers’ retirement system that the city shortchanged for years.

Yet buyers haven’t been hurt by defaults as the growing economy boosts government tax collections. With the exception of Puerto Rico, only one bond issuer rated by Moody’s — Dowling College in Oakdale, New York — failed to pay investors during the past two years. That’s the first time that’s happened since the 1990s.

Bankruptcies have also been scarce: Just Hillview, Kentucky, population 8,000, has sought court protection from creditors since Detroit did so two years ago.

Municipal securities carry an average rating in the AA tier, an advantage in a tumultuous global market, Vanguard’s Alwine said. It also helps that few localities would be directly affected by an slowdown in China or elsewhere overseas.

“It’s a high-quality market and it’s all domestic-focused,” he said. “You have this weaker overseas growth, but when you look at munis, they’re immune to those concerns.”

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