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BlackRock, Citi Say Buy Munis as Yields Climb From 50-Year Low.

Just weeks removed from the lowest municipal-bond yields in 50 years, BlackRock Inc. and Citigroup Inc. are imploring investors to buy.

Their recommendation stems from a confluence of factors, ranging from depressed yield levels worldwide to an imbalance of supply and demand in the $3.7 trillion municipal market. Though 10-year yields have climbed in March in six of the past seven years, now might be the best chance to buy tax-exempt debt, according to Vikram Rai, head of muni strategy at Citigroup in New York.

“This year, we expect that the cheapness could be relatively short-lived and we strongly recommend that investors utilize this temporary cheapness as buying opportunities before yields plummet again,” Rai said in a Feb. 29 report. “This is not the time to sit on the sidelines.”

Fixed-income investors have had to re-calibrate their expectations in 2016 as China’s economic slowdown and plunging oil prices have buffeted global equity markets, spurring demand for the safest assets. In the U.S., yields have plunged even though the Federal Reserve raised its target for the first time since 2006. That’s made muni buyers wary of calling a bottom to rates.

BlackRock, the world’s largest money manager, shares Citi’s view of taking advantage of increased yields.

Supply is building in the coming weeks, making it tougher for states and cities to borrow at current levels. They may have to offer investors better deals.

“Seasonal weakness, when we see that, is often a good opportunity to buy at better value, so look for that coming up in the near-term,” said Peter Hayes, who oversees $110 billion of state and local debt as the head of BlackRock’s muni group.

Here are four charts that show what BlackRock and Citi see in the market.

Absolute Advantage

Benchmark 10-year muni yields have climbed from near-record lows, making them more appealing to fixed-income investors. At 1.76 percent, the Bloomberg index is the highest since January and up 0.2 percentage point from Feb. 11.

Before the yield increase, some individual investors were in “rate shock,” Rai said.

“It’s really nothing more than the market hitting resistance,” said Sean Carney, head of muni strategy at BlackRock. “It’s a pullback in a market that has come a long way and is going to assess the next move.”

Supply Glut

An increase in municipal-bond supply gave investors the opportunity to be more picky in their purchases, leading to higher yields. Long-term fixed-rate issuance reached $9.8 billion in the week through Feb. 26, the highest since November, data compiled by Bloomberg show.

"Some of the more recent deals have been met with a little bit more resistance," Hayes said. "Supply is likely to pick up — especially given the fact that rates are so low."

Crowded Market

State and local governments have scheduled about $15 billion of bond sales in the next 30 days, the largest slate since November, Bloomberg data show. The figure tends to underestimate the amount of offerings because some are announced just days in advance.

That's a trend muni investors usually encounter. Issuance in March has exceeded that in January and February each year since 2012, Bloomberg data show. That contributes to benchmark yields typically increasing during the month.

What could offset that this year is if non-traditional muni investors consider the bonds with global yields near record lows, Rai said. While corporate debt seems cheap to state and local securities, munis benefit from the flight to safe assets that has pushed U.S. Treasury yields lower and 10-year debt from Japan and Switzerland to below-zero rates.
Relatively Cheap

The 1.76 percent yield on benchmark 10-year munis compares with 1.75 percent on similar-maturity Treasuries, Bloomberg data show. The ratio is a measure of relative value between the asset classes. It climbed to 101 percent on Monday, the highest since October, signaling that tax-free bonds are cheap relative to their federal counterparts.

Investors who don't benefit from tax-exempt interest will occasionally cross over and add munis when their absolute yields increase. Over the past 10 years, the ratio has averaged 97.6 percent. For an individual in the top federal income-tax bracket, the muni yield is equivalent to 3.1 percent on taxable securities.

Munis overall have returned 1.2 percent this year, compared with 3.2 percent for Treasuries, Bank of America Merrill Lynch data show. For tax-exempt debt, coupon payments have driven most of the gains, rather than a jump in bond prices.

The underperformance to Treasuries hasn't yet turned muni mutual fund flows negative. Rather, they've seen money pour in for 21 straight weeks, the longest stretch since December 2014, Lipper US Fund Flows data show.

"We're going to tend to underperform when rates fall, as they're doing now, particularly in this flight to quality we're seeing in U.S. rates," Hayes said. "But when rates do rise, we tend to outperform."

Bloomberg Business

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February 29, 2016 — 9:00 PM PST Updated on March 1, 2016 — 5:48 AM PST