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Muni Demand Won't Waver Anytime Soon.

BlackRock's municipal group said any seasonal pullback in the market this month should be seen as restoring value and presenting a buying opportunity.

Entering June, BlackRock shortened duration in its portfolio in recognition of the market's strong run and increased gross issuance. Issuance generally picks up meaningfully in June, the market's worst-performing month over the past five years, but considering the uptick this May, the usual pattern may not fully develop, BlackRock wrote in its monthly municipal market update.

"On balance, we would see any pullback as healthy, short lived and a potential buying opportunity," the report said. "We continue to favor the A-rated space, revenue bonds and the health care and transportation sectors."

In a presentation to reporters Wednesday Peter Hayes, managing director and head of the municipal bonds group, pointed to the strong demand.

"We are seeing a lot of non-traditional buyers have [become] interested in the asset class as well just because global rates are so low and in many cases, negative," he said.

"$28 billion coming into the asset class this year alone is phenomenal but it is not sustainable," said Blackrock Director Sean Carney, head of municipal strategy. "Because of what is driving it, we don't see any catalysts that will change it. Fund flows are the product of past performance and future rate forecasts. Performance has been better than good and future rate forecasts are sideways to lower."

Carney noted the deals have been digested easily and oversubscribed as issuance picked up, as sellers offered a something for everyone with bonds that are evenly distributed across the credit curve.

"2016 issuance is still running about 19% above the five and 10 year average, although its true its down about 7% year over year but we are still on track to end the year around $400 billion and we are about to enter a strong seasonal pattern," Carney said. "Coupon payments will be coming in soon and get re-invested in the market, come July and August."

Illinois, which still doesn't have a budget, is going to access the market with only a minor penalty on yields, the Blackrock strategists said.

"I think it has gotten some attention but the struggle over what is preventing the budget from passing to me is more indicative of the broader market and more problematic of things you might see going forward," said Hayes.

Yesterday, Illinois announced plans to borrow $550 million on June 16. The Prairie State is currently the lowest rated U.S. state.

"We as municipal market participants should really be penalizing in some way, by almost not giving them any access to the market," said Hayes. "Think about it, they are a state without a budget, they refuse to pass a budget, they have the lowest funded ratio on their pension of any state, and yet they're going to come to market and borrow money."

Carney said the strong demand has reduced the penalty for fiscal problems.

"Spreads have widened quite considerably," he said. "There are a few ways to look at it. One way is that you see the spreads widening but another way to look at it is that with rates continuing to fall, even though they are coming in at wider spreads, the all-in interest cost is not that much greater then where they were, when they previously issued."

The Bond Buyer

By Aaron Weitzman

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