

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

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## **Think Governments Are a Mess? Markets Don't.**

Fear mongers on both sides of the Atlantic would have us believe that governments are failing. They cite racially-charged violence from Dallas to Charleston, South Carolina; voters in Britain choosing to exit the European Union; the flood of migrants from the war in Syria; terrorist-inspired massacres from Brussels to San Bernardino, and the anemic global economy that is dividing generations of workers, families and communities.

Among investors, though, the full faith and credit of governments is at an all-time high, according to data compiled by Bloomberg. If low interest rates on sovereign debts are the ultimate measure of confidence in the governments that issue them, the market remains unshaken. The yield on short- and long-term securities has never been lower, according to Andy Haldane, chief economist and executive director of monetary analysis and statistics at the Bank of England.

As these interest rates are benchmarks for state and local governments, their cost of borrowing has plummeted to record lows as well. U.S. municipalities are financing at 1.54 percent this month, less than the 1.67 percent of 1945 or 4.71 percent of 1933, according to Bloomberg data and the U.S. Government Publishing Office.

The once-widening budget deficit as a percentage of gross domestic product is shrinking in the U.S., to 2.5 percent from 10.1 percent in 2009, and is now a 0.7 percent surplus in Germany.

### **30-YEAR RETURNS**

For bondholders, the total returns (income plus price appreciation) have been a bonanza — surpassing gold, the fear monger's favorite store of value. During the past 30 years, global sovereign debt returned 576 percent, or more than twice the 271 percent return for gold, while U.S. Treasury securities returned 529 percent, according to Bloomberg data. The yield on the 10-year Treasury note, which climbed to a high of 15.8 percent in 1981, is 1.3 percent this month, the lowest since Bloomberg began compiling such data in 1962.

### **Secular Stagnation**

The record-low rates are a symptom of what many economists, led by former Treasury Secretary and former Harvard President Larry Summers, call secular stagnation: Slowing population growth and insufficient technological innovation and capital investment. These economists also see the low rates on U.S. and other sovereign debt as the most propitious opportunity to get economies moving faster because governments can borrow so cheaply to pay for infrastructure improvements, thereby creating demand from higher-paying construction jobs while investing in everyone's future.

The market agrees. So far in the 21st century, the bonds sold to finance roads, bridges, hospitals, sewers and schools have outperformed all state and local government debt as well as the stock market and even gold, according to Bloomberg data. That's because of the combination of after-tax returns and record-low financing costs. The borrowing cost to toll and turnpike authorities, a proxy for U.S. infrastructure financing, is an unprecedented 1.7 percent.

## PERFORMANCE SINCE 2004

Since such data became available in 2004, toll and turnpike bonds returned 89 percent, easily beating the 74 percent benchmark for the municipal-securities market. The Standard & Poor's index of U.S. stocks had an 87 percent after-tax return for those in the lowest 28 percent tax bracket — since most investors in tax-exempt securities are in the higher 35 percent tax bracket, though, the advantage to investors in infrastructure bonds has actually been greater.

To be sure, nothing approached gold's 403 percent return during the past 15 years when global high-yield corporate bonds returned 223 percent, investment grade corporate bonds 139 percent, global sovereign bonds 132 percent and Treasuries 102 percent. But gold's price fluctuations are four times that of U.S. Treasuries. On a risk-adjusted return basis, gold has been lagging all categories of the credit market. During the past five years, for example, global high-yield corporate bonds gained 32 percent, followed by U.S. Treasuries at 19 percent, global investment-grade bonds at 18 percent and global sovereign debt at 9 percent. Gold lost 16 percent, according to Bloomberg data.

Gold also loses when taxes are taken into account. U.S. infrastructure debt is mostly tax exempt, which helped it outperform stocks and bonds not only in the long term but also during the past two years and, most recently, during the last 12 months. In that year they returned more than 10 percent compared to the municipal-bond benchmark of 8 percent and the S&P 500's 3.6 percent after-tax return. During the past 10 years, when infrastructure bonds returned 82 percent, gold gained 76 percent on an after-tax basis (assuming most investors are in the 35 percent tax bracket) and gold's volatility, or price fluctuations, was almost six times that of bonds.

So far this year, nothing comes close to matching the returns of infrastructure debt in the municipal market, where North Carolina Turnpike Authority debt has appreciated more than 22 percent, followed by Colorado's E-470 Public Highway Authority's 12 percent and California's Riverside County Transportation Commission's 11 percent, according to Bloomberg data.

So when Larry Summers calls for "a new approach" starting from "the idea that the basic responsibility of government is to maximize the welfare of citizens, not to pursue some abstract concept of the global good," and to let people "feel that they are shaping the societies in which they live," the market already has ratified this policy by making infrastructure one of the best investments of our time.

### **BloombergView**

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