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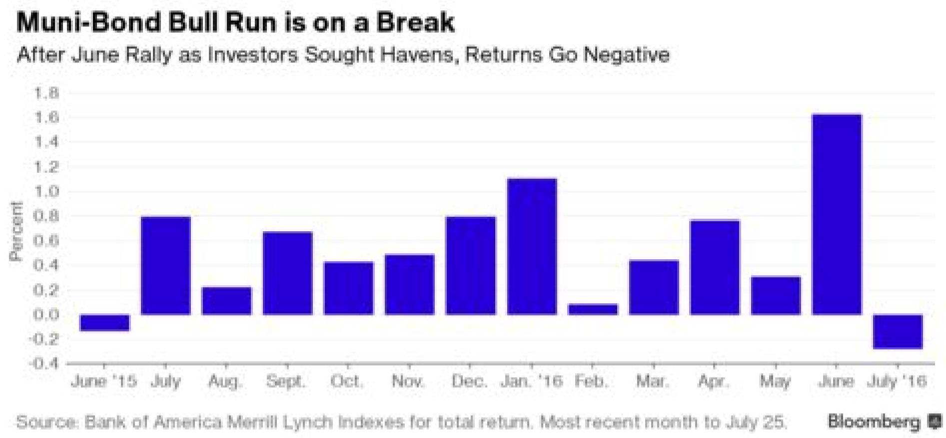
Muni Bonds Poised for First Loss in 13 Months After Brexit Rally.

The municipal-bond market's one-year winning streak is taking a breather.

State and local-government debt has lost 0.25 percent in July, headed for the first monthly decline since June 2015, Bank of America Merrill Lynch data show. The drop marks a pullback after the securities rallied in June by the most in 17 months as investors rushed into the safest assets amid concern about the impacts of the U.K.'s vote to exit the European Union.

"It's just a give back from Brexit," said Adam Buchanan, senior vice president of sales and trading at Ziegler, a broker-dealer in Chicago. "The reason the month is down is because Brexit drove the market artificially high for a short period of time."



The bull run in tax-exempt securities had sent prices to record highs as investors plowed money into municipal mutual funds, with the Federal Reserve holding off on raising interest rates since the quarter-point increase in December. While state and local debt returns are still up 4.2 percent this year, on track for the third straight annual gain, some investors are locking in profits, speculating future returns may be muted.

Municipal yields, which move in the opposite direction as price, climbed to the highest in more than a month this week. By the start of this week, benchmark 10-year yields were 1.48 percent, the highest since June 23, according to data compiled by Bloomberg. The yield for the Bond Buyer 20 Index last week edged up to 2.87 percent after slipping to as little as 2.8 percent earlier this month, the lowest since at least 1961.

A retreat is normal after this "stellar" run, said Phil Fischer, the head of municipal research at Bank of America Merrill Lynch.

"This is not Armageddon," Fischer said. "It's not a bad idea for people to pause and take a look at their portfolios."

With borrowing costs low, state and local governments have increased sales of debt before the Fed boosts rates again. The increase in the supply of new securities has been a drag on the market during the second half of July, said Dan Solender, head of municipals at in Jersey City, New Jersey for Lord Abbett & Co., which manages $20 billion of the debt.

U.S. policy makers left rates unchanged during Wednesday's Fed meeting while noting that the risks to the economy have subsided. Investors project a 26 percent chance that policy makers will hike rates at the next meeting in September, according to pricing interest-rate futures markets.

There are about $12 billion of bond sales scheduled over the next 30 days, the most in three weeks, according to data compiled by Bloomberg. The actual amount might be higher as some deals are made public only days ahead of time.

Still, there's been plenty of cash flooding into the market. Investors have added money to municipal-bond mutual funds for 42 straight weeks, according to Lipper US Fund Flows data. Inflows reached $1 billion in the week ended July 20, following $1.22 billion the previous week.

"Our demand is so strong, and we still have some good relative value versus other markets," said Solender. "For now, that's definitely still drawing interest to our market."

Bloomberg Business

by Elizabeth Campbell

July 27, 2016 — 2:00 AM PDT Updated on July 27, 2016 — 11:41 AM PDT

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