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Muni Tobacco Bonds Rally as Buyers Swoop in After Trump Selloff.

- Fundamentals remain solid, according to Barclays strategist
- Cigarette shipments declined 3.5% in 2016, Altria says

State and local government tobacco-settlement bonds are bouncing back from the drubbing they took in November as investors pick up the debt on the cheap and cigarette consumption declines remain moderate.

The securities, which are repaid with payments from tobacco companies under a 1998 settlement, returned 7.7 percent over the past two months, four times more than investment-grade debt, according to Bloomberg Barclays indexes. That rebound pared a 9.2 percent loss in November, when fund managers sold the securities — which are among the most liquid high-yield munis — to meet redemptions during the bond-market rout that erupted after Donald Trump's presidential victory.

"There was really no reason for tobacco to get hammered in November," said Mikhail Foux, head of municipal strategy in New York at Barclays Plc. "People just sell what they can, not what they should."

The settlement payments that back the tobacco bonds are based on cigarette shipments, which have declined at a slower pace as the low price of gasoline leaves consumers with more money to spend.

Altria Group Inc., which sells Marlboro brand cigarettes in the U.S., reported on Feb. 1 its domestic shipment volume declined about 3.5 percent in 2016, in line with its competitors. From 2007 to 2014, shipments fell an average of 4.7 percent annually, according to data from the National Association of Attorneys General, which monitors the settlement.

Jeffrey Burger and Dan Barton, who co-manage the Dreyfus High Yield Municipal Bond fund, expect shipments to fall 3.5 percent in 2017. The \$162 million fund, the best performing open-end high-yield muni fund this year, had about 13 percent of its assets invested in tobacco bonds as of Dec. 31, according to data compiled by Bloomberg.

One cloud on the horizon: California, which accounts for more than a tenth of the tobacco industry's sales, on April 1 is raising cigarette taxes by \$2 per pack, which may crimp sales 0.6 percent or 0.7 percent, Barton said. Dreyfus factors state cigarette-tax increases, including California's, in its financial models, he said.

IHS Global, an econometric consultant, forecasts consumption to decline about 3.5 percent per year through 2020, according to an offering statement for a New York City tobacco bond issue last month.

"We would expect to see more state tax increases going forward as states look to balance their budgets," Barton said. Six states raised cigarette taxes in 2016, while 10 increased their rates in 2015.

A federal excise tax increase, which would have a greater impact on consumption, isn't imminent, given the Trump administration's push to reduce taxes and cut regulation, Burger said. When the federal government raised cigarette taxes 62-cents-a pack in 2009, sales fell 9.2 percent.

"There's no indication that a Trump administration would ever pass through any kind of federal excise tax increase," Burger said.

Moreover, if Trump and the Republican-controlled Congress enact policies to expand manufacturing, lower income taxes and possibly raise the minimum wage, discretionary income and demand for cigarettes should increase, helping to offset the drop in sales anticipated from the California measure, Foux said.

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by Martin Z Braun

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