Bond Case Briefs

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What's Ahead for Munis? Forecasters Who Got It Right Make Calls.

- MacKay Shields' Loffredo, DiMella offer guidance for 2017
- The muni debt chiefs made prescient predictions for 2015, 2016

John Loffredo and Robert DiMella, co-directors of municipal debt investments for MacKay Shields, have been reliable guides to what the coming year will bring in the state and local government bond market.

The two money managers, whose company oversees about $94.5 billion, have issued annual forecasts for the past two years that largely proved prescient, correctly anticipating that tobacco-settlement bonds would rally, transportation-related debt would outperform and any price drops would be exaggerated by a pullback in money from the market. During the last three years, shares in their MainStay Tax Free Bond Fund have delivered annual returns of about 4.9 percent, beating some 86 percent of their peers, according to data compiled by Bloomberg.

Here's their major market predictions for 2017:

Liquidity Improves

The amount of money flowing in the market is likely to pick up, they say, amid a rollback of financial regulations and oversight. President Donald Trump this week said, "we're going to be doing a big number on Dodd-Frank," the law Congress enacted to prevent a repeat of the 2008 market meltdown. There are signs that liquidity is increasing, with trading volume rising last year and brokerage firms boosting their exposure to the market, according to regulatory data.

High-Tax, High Returns

Loffredo and DiMella predict that debt sold by governments in higher-tax states will outperform those from states where residents' incomes aren't taxed as much. Why? If federal levies are reduced, as Trump plans, those bonds will still be sought out because they're exempt from state income-taxes, too. That would mark a shift from 2016: Debt from California, which has the highest marginal rates, returned 0.28 percent last year, about half as much as those from Texas, which has no income tax at all, according to S&P Global Ratings indexes.

Beating Treasuries

MacKay's money managers say that municipals will outperform Treasuries as uncertainty about the size and scope of Republican tax-cut plans subsides. While lower rates on individuals would decrease the relative value of municipals, Trump has expressed support for keeping intact the federal tax breaks given to buyers of state and local debt, according to mayors who met with him before he took office. If municipals outperform, the yields — which move in the opposite direction as price — would decline relative to Treasuries.

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by Jordyn Holman

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