Bond Case Briefs

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Asian Insurers Developing Appetite for Taxable Munis.

A growing number of insurance companies in Tokyo, Seoul and Taipei are doing their part this year to make American infrastructure great again.

Their investment vehicle of choice: U.S. taxable municipal bonds, growing but still less than 15% of the $3.8 trillion U.S. muni market. That market — a focus for U.S. retail investors — remains dominated by tax-exempt bonds state and local governments issue for public-interest-related infrastructure investments.

Taxable muni bonds, by contrast, help fund projects with a private-interest element, such as retail concessions at airports. They typically offer healthy spreads over the yields on tax-exempt bonds, which could be used to fund the construction of runways, for example.

In a March interview, Atsushi Tachibana, Japan Post Insurance's managing executive officer in charge of investments, said his team invested in taxable U.S. munis in the fiscal year ended March 31, favoring them over lower yielding tax-exempt munis. Mr. Tachibana declined to comment on talk that Kampo, as his organization is known, issued $1 billion in taxable muni mandates.

At Dongbu Insurance, a fixed-income representative confirmed in April that Eaton Vance (EV) Management (EV) was awarded a $100 million taxable municipal bond mandate.

Other insurers in Asia — including Korean Reinsurance Co. and Kyobo Life Insurance Co. Ltd, both of Seoul — have issued RFPs for U.S. taxable munis in recent months, according to money management executives who declined to be identified. A Korean Reinsurance spokesman declined comment. And a source familiar with Kyobo Life, who declined to be identified, said the insurer is looking to award U.S. taxable muni mandates to two managers at the end of June. He didn't offer details on the size of the mandates.

A spokeswoman for Standish Mellon Asset Management said the firm recently won a taxable muni bond mandate from a Korean institution but declined to elabo details.

Growth predictions

Executives with global money management firms predict continued interest in taxable U.S. muni allocations from insurance companies and other long-term investors in Europe and Asia, even as the latest U.S. Federal Reserve data showed outflows of $17.2 billion for the first quarter, leaving outstanding foreign holdings of U.S. taxable munis at $90.4 billion. The outflows largely offset combined inflows of $19.3 billion over the prior two quarters.

Thomas McLoughlin, New York-based managing director and head of fixed income, Americas, with UBS Financial Services, said the case remains intact for expected increases in foreign investor flows to taxable munis. The latest quarter's data might reflect an apparent bout of profit-taking on the back of a powerful recent market rally, which saw valuations swing quickly to rich in the months following the U.S. presidential election, he said.

Bernhard Fischer, New York-based senior fixed-income analyst (municipal bonds) with Principal Global Investors, said despite first quarter outflows, “we can say with certainty that interest has increased significantly,” judging by international RFP inquiries. Interest from Asian investors, which was focused in Japan last year, broadened to the rest of Asia in 2017, said Mr. Fischer. Plus, European insurers also set out several RFPs, and PGI’s sales team in Australia is likewise seeing growing prospects, he said.

James Welch, a New York-based taxable muni portfolio manager with PGI, tied the prospect of continued growth by foreign investors to their efforts to familiarize themselves with the asset class since yields went negative for large swaths of developed market sovereign bonds.

Over the past 12 to 18 months, institutional investors outside of the U.S. have been putting considerable time and effort into learning about the taxable muni market, and now a growing number are ready to take advantage of opportunities the market presents, agreed Cynthia Clemson, Boston-based co-director of municipal investments with Eaton Vance (EV) Management (EV).

A combination of factors — including superior yields, high credit quality and relatively low correlations with other major asset classes — is coming together now to make taxable U.S. muni bonds a viable asset class for institutional investors around the globe, Ms. Clemson said. And with annual issuance of more than $30 billion a year, the taxable market, at roughly $470 billion today, is fast approaching the $500 billion mark, a scale that should provide further psychological comfort, she said.

Long duration

Another charm of the taxable muni market for insurers in Asia is the securities’ relatively long duration, which helps the insurers immunize their liabilities, noted Jeffrey Burger, a Boston-based senior portfolio manager on Standish Mellon’s taxable muni team.

Data from Barclays Capital show the average maturity of the bonds in the Barclays Taxable Municipal index is 17.7 years, while the corresponding figure for the tax-exempt index is 12.8 years.

While being able to tap bonds with maturities that extend well beyond other credit alternatives is an attraction for insurers across the region, recent changes to regulations in Korea could add further incentives for insurers there.

Stella Ng, a Hong Kong-based analyst with Moody’s Investors Service, said amended risk-based capital requirements for Korean insurers announced May 31 by the country’s regulators will raise the maturity cap on insurance liabilities to 30 years from 20 by the end of 2018. That will leave insurers under pressure to better match their assets and liabilities or risk weakening their risk-based capital ratios. “We expect the trend of increasing overseas investments” — including investments in U.S. municipal bonds — “will continue because insurers are seeking more long-dated securities to match their insurance liabilities,” said Ms. Ng, in an email.

Mr. Burger, who was in Asia the week of May 29 to visit clients in Japan, Korea, Hong Kong and Australia, said still another advantage of taxable muni bonds now is their more defensive nature in a rising rate environment. The yield for the benchmark Bloomberg Barclays Taxable Municipal Bond index ended 2016 at 3.78%, besting the tax-exempt Bloomberg Barclays Municipal Bond index’s 2.65% and the benchmark 10-year Treasury’s yield of 2.48%.

PENSIONS & INVESTMENTS

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