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Massive Muni Rally Not Enough to Prevent Fund Outflows.

- **Muni yields had fallen to 15-month low against Treasuries**
- **Pullback may test demand for $18 billion of deals next week**

Municipal bond buyers are taking a breather after the market's biggest rally since August 2011, with firms reporting that investors pulled over $800 million from state and local bond funds over the course of a week.

The yields on benchmark 30-year bonds edged up 0.05 percentage points on Friday to 2.61 percent, stepping back from the price gains that had sent yields tumbling by 0.35 percentage points in the five days through Wednesday. That had left tax-exempt securities less of a draw by reducing their yields to the lowest relative to Treasuries since September 2016.

"Ratios to Treasuries have dropped to levels that present less value for crossover investors and they probably fueled the pace of the recent rally," said Daniel Solender, head of municipals at Lord Abbett & Co., which manages about $20 billion of state and local government securities.

State and local governments are planing to sell $18 billion in debt next week, continuing a potentially record-setting wave as the tax-overhaul legislation in Congress threatens to pull the subsidies from a large swath of municipal securities beginning next year.

Investors have so far eagerly snapped up the new offerings, anticipating that the supply of tax-exempt bonds will fall next year, making them more valuable to investors.

But some buyers have shifted money away from the market. Investors yanked $807 million from municipal bond funds during the week ended Dec. 6, the biggest weekly outflow since June, according to Lipper US Fund Flows data. The outflows this past week reverse a four week-long streak of inflows.

Solender said some of the outflow may have been driven by withdrawals from funds focused on shorter-dated bonds, a segment that would be particularly affected by rate increases from the Federal Reserve.

"Given the heavy forward supply, uncertainty about flows and lower relative value, there is probably a slight pause to see how the next few deals do and to see whether the pace of selling by funds increases," he said.

Bloomberg Markets

By Martin Z Braun and Amanda Albright

December 8, 2017, 9:36 AM PST

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