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Municipal Bond Funds See Record Inflows to Kick Off New Year.

Municipal-bond funds saw $3.1 billion of net new money last week, says ICI

It’s only been a month and municipal bond funds are on a tear.

The Investment Company Institute estimated that muni bond funds saw net inflows of $3.1 billion for the week ending Jan. 10. That record-breaking sum is the biggest since the survey began in January 2007.

The bullish flows into munis represents a turnabout for the a sector that a few weeks ago looked bleak. As President Donald Trump’s tax plans rushed toward completion, muni-focused mutual funds saw around $1.3 billion in net outflows in December.

At one point, the Republican tax bill threatened to do away with interest deductibility for municipal paper, which would have produced a major headwind for muni investing.

That’s because the principal target investor for munis is wealthy individuals looking to cut their tax bill and earn tax-free interest income. Other measures included a repeal of private activity bonds, debt sold by municipalities to finance the projects of corporations like airports.

But sentiment over the sector swiftly turned bullish once the tax plan took its final and more benign form.

“Flipping that pancake to the other side, once the tax bill was finalized and signed, and once it became apparent that the tax rate for the top bracket was very high. Once that all became definitive, perhaps folks that took the outflow train took the inflow train,” said Alan Shankel, municipal credit strategist for Janney Montgomery Scott.

Analysts now say negatives of the overall tax plan should be diminished. The Republican tax bill outlawed the use of so-called advanced refunding bonds, a roundabout way for municipalities to refinance their debt. Such bonds represented 15% of total issuance over the past decade, estimated Abigail Urtz, municipal strategist for FTN Financial.

The diminishing supply could give a boost to municipal bond-buyers and push yields lower. Debt prices rise as yields fall.

However, it may not all be rosy for munis.

Urtz said the outlook for demand could be a major wild card because one of the chief pieces of the bill was a cut to the corporate-tax rate to 21% from 35% this year.

The reduced corporate-tax rate may undercut appetite from banks and insurance companies, which have grown into significant players in the municipal-bond market (see chart lower). Banks now own more than $500 billion of the $3.8 trillion sector, according to Federal Reserve data.

“With banks the fastest growing buyers of municipals in recent years, fears about tax reform’s impact on the municipal market have naturally focused on this provision,” she said. “These buyers will be grappling with some sticker shock as previously cheap valuations start to look less appetizing.”

Market Watch

by Sunny Oh

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