

Bond Case Briefs

Municipal Finance Law Since 1971

Muni Market Recap: Summer Lovin' for Munis.

Municipal bond markets go into summer slumber right around the last day of the school year. This year, the muni slumber has so far lead to an outperformance of municipal bonds relative to US treasuries.

As schools let out, bond traders, bankers and community financial officers stop making excuses for working too hard and everyone goes on vacation. In addition to taking some time for R&R, there's also a greater willingness to take vacation due to the collective liberation that comes from knowing your opponent is likely resting with a pina colada too.

The environment is self-fulfilling because the lack of activity breeds a more relaxed market environment. The most surprising aspect of the absence of market participants and lower trading activity is the trend for municipal bonds to outperform US Treasury bonds during the summer.

The muni/treasury ratio is the best measure of the relationship between Municipal bonds and US Government bonds. The muni/treasury ratio is the yield of Munis divided by the yield of US Government bonds, eg. 1.55%/2.60% (based on market clearing trade data as per MSRB and Bloomberg). This ratio usually reflects the tax benefit for owning a Municipal bond versus US Government bonds.

Munis have had good performance through the quiet of the summer. The 2 year part of the municipal curve has performed the best, with ratios decreasing from 65% to 60% (based on Bloomberg BVAL yields). 10 year ratios have decreased from 85% to 84%. The term used for this experience is outperformance or richening of Munis versus US Treasuries.

So why have munis outperformed? With everyone on vacation, literally and figuratively, everything slows, bankers stop calling communities to fund projects and community leaders make plans to begin the funding of future infrastructure again in September.

Still, while we're all getting some much needed sun, the July 1 coupon payments and principals for past deals are paid into mutual fund accounts and the cash demands to be put to work in the form of new issue municipal bonds. The imbalance between consistent/increasing demand is met with lower new issue supply during the summer and this imbalance leads to municipal bond outperformance.

PS. Don't get any crazy ideas, the market is quiet for a reason: it is a delicate balance and the market participants could not handle heavy supply of municipal deals.

Note: The data are an amalgamation of market clearing yields from MRSB trade data. They are approximate Muni Yields and are not transactable.

Investing in municipal securities contains risks, including loss of principal. Please read the official statement before investing in any municipal security. Securities offered through Neighborly Securities, Member FINRA, SIPC and registered with MSRB.

Posted 07/20/2018 by Homero Radway

Neighborly Insights

Copyright © 2024 Bond Case Briefs | bondcasebriefs.com