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Short Supply Supports Muni Bonds This Year.

The Bloomberg Barclays Investment Grade Municipal Bond Index has returned 0.49% and the corresponding high yield municipal index has returned 1.07%, quarter-to-date.2 We believe this strong muni performance was due in part to investor risk aversion that has benefitted both municipal bonds and Treasuries as well as a reduction in muni supply following the 2017 tax reform.

Tax reform created a rush to market in late 2017

The Tax Cuts and Jobs Act (TCJA) introduced in November 2017 created new concerns for municipal bond issuers. Uncertainty about the implementation of new policies resulted in a surge of new issuance at the end of 2017 that was originally scheduled for early 2018.

Among the concerns ahead of the TCJA's final passage was it would eliminate private activity bonds (PABs), which help private companies, non-profit organizations and public authorities fund projects using tax-exempt municipal bonds. While this was not part of the final bill, uncertainty persisted until mid-December.

The law did, however, eliminate tax-exempt advance refunding bonds. These had allowed government issuers and non-profits to restructure eligible tax-exempt debt by refinancing at a lower rate or for a longer term. The uncertainty around PABs and the elimination of advance refunding bonds resulted in a spike of new issuance during December 2017 — $62.5 billion was issued that month alone. As a result, muni supply during the fourth quarter of 2017 was the highest it has been in the 32 years that the data have been recorded.3

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