

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

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## **Meet the Municipal Bond Investor Who Looks Everywhere for Deals.**

Nothing hampers a good money manager quite like a restrictive investment style. This can be especially so with bond managers, as bond returns are generally lower than those of stocks and often similar for specific kinds of bonds that move in lockstep with another, so long as none default.

Of course, flexibility's no guarantee of success. After deducting their fees, managers with bad luck or little skill will underperform their benchmarks even more than index-hugging peers if they choose to "think outside the box" with the wrong securities. But for a skilled manager, a go-anywhere style will produce the best results.

Such is the case with Adam Weigold of Eaton Vance Municipal Opportunities (ticker: EMOAX).

"We started this fund in 2011 as one that would have full flexibility to go anywhere in the muni market and essentially seek out the best returns," Weigold says. "Back then, that was very unusual in our market." Such flexibility has enabled him to beat his benchmark—the Bloomberg Barclays Municipal Bond Index—and 97% of his peers in Morningstar's Muni National Intermediate fund category over the past five years. The \$1 billion fund's cumulative return since its May 2011 inception is 42%, versus the benchmark's 31%, and almost double the fund category's 23% average.

And that's despite having a higher-than-average 0.96% expense ratio.

The municipal-bond market favors managers who do deep credit analysis because it's so opaque and fragmented, allowing investors who turn over a lot of rocks to find undiscovered gems. "There are about 60,000 credits in our market with 1.2 million Cusips [the equivalent of ticker symbols for stocks]," Weigold says. "We have one of the deepest benches in credit research here with 16 analysts."

A favorite strategy currently that plays to Eaton Vance's analytical strengths is to find possible takeover candidates in the municipal hospital sector. Bonds for takeover targets usually receive a credit rating upgrade when they're acquired by a bigger hospital with a stronger balance sheet. Such upgrades also cause the value of their bonds to rise.

"Look at Care New England Health System (Cusip: 14165LAA3), which is our fifth-largest holding," Weigold says. "This is a BB-rated hospital [in Rhode Island] that is currently being acquired by Partners HealthCare, which is located up here in Boston and is an AA-rated hospital. So when that merger occurs, the bonds that I bought at a BB level will become AA and the yield spreads [between the lower-rated and higher-rated bonds] will compress as prices go up." In consequence, Care New England has been one of Weigold's best performers. As of the end of September, such hospital bonds accounted for 21% of his portfolio.

While credit research is vital to Weigold's strategy, the best bonds in the wrong sector for the current macroeconomic environment often still won't work. So he adjusts his portfolio based on his macro outlook. This year, the fund increased its weighting to 18% in floating-rate muni bonds such

as those issued by Connecticut's Hartford HealthCare Obligated Group (20774YVL8) and New York's Triborough Bridge & Tunnel Authority (89602N6Q2). Such bonds adjust their yields with interest rates, acting as a "defensive strategy" in our current rising interest-rate environment.

An alternative defensive strategy would be to buy regular short-term bonds that are less sensitive to rate increases. Yet Weigold says "everybody and their brother is doing that," and, as a result, "the front end of the muni yield curve has gotten a little rich." Still, he has been buying lower-quality B- to BBB-rated short- and intermediate-term bonds with durations in the one-to-five year range, which he says offer better value: "That has been one of our big calls this year so we could take some interest-rate risk off the table but not necessarily give up the income. And that has been a good place to be year to date." As of Sept. 30, 44% of the fund was in bonds rated BBB or below, an increase from 35% a year ago.

The other big macro theme that Weigold is focusing on is the recent federal tax reforms' impact on munis, which is far more complicated than it appears on the surface. For instance, while the decrease in the top federal income-tax rate from 39.6% to 35%, and the corporate tax rate, from 35% to 21%, makes muni returns less attractive to individual and corporate investors, the capping of the state and local tax, or SALT, deduction at \$10,000 makes munis much more attractive in high tax states like California and New York, as high earners can no longer write off much of their income.

"The SALT deduction cap is going to hit these tax payers in high-tax states much more than they realize," Weigold says. "They'll be looking to shield their income once they do their taxes in April." Almost a year ago, he had 11% of his fund in California bonds, but has since reduced that weighting to 8% because of valuation concerns and shifted assets to New York ones, which are now 16% of the fund. "California demand has been off the charts because it has a top tax rate of 13%," he says.

Another tax-reform-related strategy is to buy bonds subject to the alternative minimum tax, or AMT, which exists to ensure that the highest earners pay some tax. AMT bonds were once considered unattractive because the wealthiest investors couldn't benefit from the bonds' tax-free yields. But the new tax laws will dramatically reduce the number of rich Americans subject to the AMT from five million in 2017 to 200,000 this year, according to Tax Policy Center's estimates. That means AMT bonds, which generally yield more than non-AMT ones to entice investors to buy them, will now be tax-free for more investors. One of Weigold's largest positions, a BBB-rated muni bond for Delta Airlines (650116CG9) to build a new terminal at LaGuardia Airport in New York, is an AMT bond.

"The idea is that come April of next year, when muni buyers figure out they're not subject to AMT, they might be more interested in paying for AMT bonds," Weigold says. "So we've increased our AMT exposure to almost 15% from about 9% earlier in the year." It's that sort of astute maneuvering that should help Weigold stay ahead of his peers going forward.

## **Barron's**

By Lewis Braham

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