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Citigroup Bucks Herd in Call for 'Intense, Prolonged Rally' in Muni Market.

- **The investment bank says munis may return more than 8% in 2020**
- **Tax-exempt municipal bonds gained more than 7% last year**

Citigroup Inc. analysts are standing apart from the Wall Street pack by predicting that the municipal-bond rally may be gaining steam.

Vikram Rai, Jack Muller and Vedanta Goenka, who track the state and local government debt market for the bank, said in a note to clients that the securities may return more than 8% in 2020 as cash continues surging into the market. That would come after tax-exempt bonds gained more than 7% last year, their biggest annual jump in five years.

"The ongoing intense, prolonged rally, has led to gluttonous demand for tax-exempt paper, which has engendered strong performance, and is leading to more gluttonous demand," the analysts wrote.

The bullish forecast from Citigroup, the second biggest underwriter, stands in contrast to widespread expectations on Wall Street. Late last year, analysts at firms including Barclays Capital, UBS AG and Morgan Stanley predicted that the market was poised for more muted gains, given how low yields had become.

Since then, however, prices continued to rally as the amount of cash being invested outstripped the volume of new tax-exempt bonds being sold and the coronavirus outbreak increased demand for the safest assets. That drove the securities to a 1.8% gain in January, the biggest one-month advance in six years, according to the Bloomberg Barclays index. Yields are at their lowest in over six decades.

Price gains slash yields to lowest in over six decades

Citigroup's forecast is based in part on the behavior of individual investors who are by far the biggest buyers of municipal debt. As long as the market continues to gain, they tend to keep sending in their cash, creating a self-reinforcing cycle. While that can also exaggerate the impact of a downturn, the bank's analysts said they "do not see a sell-off on the horizon."

Other forecasts are more muted. Even after January's gains, Barclays analyst Mikhail Foux said he still expects investment-grade state and local government bonds to return 2% to 2.5% this year. BlackRock Inc.'s Sean Carney is forecasting similar sized gains, saying that other months "are not as friendly as January has been."

But based on its expectation for inflows to municipal bond funds, Citigroup anticipates average gains of about 8.2% across various maturities, with nearly 11% returns on 30-year bonds.

Rai said in an interview that he expects prices will inch up as the year goes on. "It's simple supply and demand fundamentals," he said.

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