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Muni Bonds Surge, Reviving From Worst Crash in Over Four Decades.

• Yields tumble by more than 60 basis points across the curve
• Junk bonds hit hard in sell-off revive as buyers swoop in

Municipal-bond prices surged, staging the biggest one-day rally in nearly three decades, as Congress and the White House struck a deal on a more than $2 trillion stimulus package to soften the impact of the economic slowdown triggered by the coronavirus.

The gains sent yields sliding sharply across maturities, but the drop was steepest for the shortest-dated securities that were hardest hit by the steep sell-off this month as fund managers dumped the easiest-to-unload bonds when investors fled en masse. Three-month benchmark yields dropped 75 basis points to 1.8% while those on 10-year bonds fell 61 basis points to 2.06%. Those on the longest-dated securities fell 61 basis points to 2.56%.

The rally gained force after the White House and the Senate reached an agreement on a massive package of spending and tax breaks in a bid to prevent the swift shutdown of much of America's economy from leading to a deep, prolonged recession. It includes about $500 billion that can be used to back loans and assistance to companies, as well as state and local governments.

The price jump was the biggest since 1993 and sent yields tumbling by the most since Bloomberg's benchmark indexes begin in 2011. The drop was roughly three times as big as the decline Tuesday and included high-yield bonds that tumbled steeply during the sell-off.

"The stimulus will be very helpful to the overall market," said James Iselin, a portfolio manager at Neuberger Berman Group. "The stimulus will inspire confidence that a bridge is being built to help get us to the other side as we continue to deal with challenges resulting from this unprecedented moment."

The two-day rally broke what had been an escalating slide in the $3.9 trillion municipal market as investors pulled cash out of mutual funds at a record-setting pace on concerns about how the economic fallout of the pandemic would affect cities, airports, hospitals and others that have issued tax-exempt bonds. The retreat saddled many borrowers with skyrocketing interest bills on floating-rate debt and effectively shut down the market for new debt issues as Wall Street banks put offerings on hold.

The Federal Reserve softened the liquidity strains by extending its lending programs to include some of the shortest-dated municipal securities, while the stimulus promises to ease the financial strains on local governments and other borrowers.

The municipal market has been whipsawed by unprecedented volatility this month, so it's not clear yet whether the rally is the start of a turnaround or a false start that could reverse if the pandemic worsens. But there are some signs that investors are swooping in to scoop up securities most affected by the sell-off.

On Wednesday, some of the most actively traded securities were floating-rate bonds issued by New York's water system, whose yields surged to 6.75% during the rout.

Bonds backed by Ohio's tobacco-company legal settlement payments, a type of security that is a mainstay of high-yield funds, surged, with those due in 2055 climbing to as much as 93 cents on the dollar from about 75 cents Tuesday.

Puerto Rico's sales-tax backed debt — which is a bellwether of the high-yield market that was dealt the steepest losses this month — were also among the most heavily traded, with the price of those due in 2058 rising to as much as 94 cents on the dollar from about 80 cents Monday.

"People are finally taking a breather and saying, 'were we too hard on credit?'" said Jason Appleson, a portfolio manager for PT Asset Management LLC. He said investors are using the time ahead of Congress' stimulus vote to take stock of their holdings and whether bonds were penalized too much, though he said he's skeptical about whether the rally could be maintained if mutual funds continue to see cash pulled out.

"It's a different mentality today," he said.

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