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Risky Munis Shrug Off Recession in Biggest Rally Since 2009.

- **High-yield muni bonds have surged 7.8% since start of April**
- **Federal Reserve's muni lending program improved sentiment**

To judge by the municipal junk-bond market, it would seem like the economic collapse is already over.

High-yield state and local government debt, the most susceptible to defaulting during a sustained slowdown, have returned 7.8% since April 1, putting them on track for the biggest quarterly jump since the end of the Great Recession in 2009.

The rally tracks the broader optimism on display in American financial market that has also lifted stocks and corporate bonds. It signals speculation by investors that even the riskiest borrowers in the $3.9 trillion municipal-securities market are likely to weather the fallout of the coronavirus shutdown that sent unemployment surging, shut businesses and decimated the tax collections of local governments.

Initial fears about the toll prompted investors to pull record amounts out of municipal-debt mutual funds in March, before the Federal Reserve revived confidence by promising to extend short-term loans to governments to head off another liquidity crisis.

“While that didn't apply to high yield in the muni market, what it did do is give people confidence that munis in general weren't all going to default,” said Lyle Fitterer, co-head of municipal investments at Baird Advisors, which manages $6 billion of state and local debt. “You saw cash flows from retail investors finally turn around and turn positive.”

Prices on some bonds that were hit the hardest in March are coming back, such as tobacco-settlement backed bonds. Ohio's Buckeye Tobacco Settlement Financing Authority debt maturing in 2055 with a 5% coupon traded Wednesday at 105 cents on the dollar, up from an average 73.2 cents on March 23, according to data compiled by Bloomberg.

The gain for high-yield municipals in the past 10 weeks follows a 6.9% drop in the first quarter of 2020, according to Bloomberg Barclays Indexes. The last time the sector jumped more in a single quarter was during the three months ending September 30, 2009, right after the formal end of the last recession, when high-yield munis gained 13.6%.

The full economic impact of the shutdowns has likely yet to be felt by many governments and the projects that have been financed in the municipal market, since they have the ability to draw on reserves and tax collections take months to fully reflect a downturn.

“It's going to take a long time for the economy to recover,” Fitterer said.

“You're going to see more debt-service reserve draws. You're going to see more technical defaults.

And longer term, it'll lead into more actual defaults," he said. "Temporarily, people have forgotten about that."

Bloomberg Markets

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June 10, 2020, 11:03 AM PDT Updated on June 10, 2020, 12:14 PM PDT