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## **Franklin Templeton Dir. of Municipal Bonds on Market Opportunities: 'Supply Demand is Actually Quite Strong'**

Ben Barber, Director of Municipal Bonds at Franklin Templeton, joins The Final Round to discuss the overall health of the municipal bonds market and what the 2020 election could mean for it going forward.

- All right. Let's switch our focus and our attention to the muni market. State and city budgets have taken a huge hit from the coronavirus pandemic, but the muni bond market, at least for now, seems to be holding up OK. For more on that, we want to bring in our next guest. We have Ben Barber. He's the Director of Municipal Bonds at Franklin Templeton. And Ben, it's great to have you on the show. Help us understand what's going on in the muni bond market. Because on the one hand, I think there is some hesitation when you see what's happening on the state and local level. But on the other hand, investors continue to pour money into muni bonds. So why do you think that is and where are you seeing opportunity?

BEN BARBER: Yeah. Thanks, Shawna. I appreciate the opportunity. I think when we talk about the muni market, we generally start with two main factors in trying to figure out evaluations. We talk about technicals, nothing more than supply and demand. And we talk about credit fundamentals. Just in general, how's the muni market doing from a downgrade, upgrade, maybe in a default perspective. And then we layer those two things against each other and try to come up with a view on evaluations. And that's usually going to be munis versus something else in fixed income. Usually that's going to be the treasured market. So unpacking that a little bit, thinking about technical. Supply and demand is actually quite strong and favorable towards the muni market. Supply has generally been shrinking on average over the last 10 years. Meaning the muni market has actually had more bonds maturing and/or being called out of the market, then are coming in the primary market. So that sets up a pretty positive technical on the supply side.

On the demand side, in general, flows have been very strong into open end muni bond funds, which is probably your best proxy for demand in the muni market. Over the last three or four years or so it's been pretty positive. At the beginning of the COVID lock down, of course, it turned horribly negative and we had record breaking outflows out of muni bond funds. But since then we've been back to positive territory. This year, for example, just year to date, the open end muni bond fund asset class is positive to the tune of about \$15 billion of net new flow into open end muni bond funds on a base of about 800 billion or so in open end funds overall. So the technical environment's actually pretty strong. The credit fundamental environment, we focus on quite a bit. And I would say that overall the muni market continues to be very, very high credit quality asset class, which is probably one of the main reasons why people are attracted to the muni market in the first place.

Defaults continue to be exceedingly low in the investment grade space of munis. They're almost non-existent. In the high yield space of munis, of course, they're more frequent but still a little low single digits on an annualized basis. Very far superior to what happens in the default rate, for example, in the corporate fixed income space. And so munis overall, from a technical standpoint, from a credit fundamentals standpoint, lineup very well right now. From a valuation perspective, it's very

interesting to think through that muni yields right now are higher than treasury yields, up and down the yield curve. A lot of people will focus on that ratio. Muni yields divided by treasury yields, it's comparable portions of the yield curve. And it's very interesting to note that ratio right now is north of 100% without taking into consideration tax exemption on the income flow of munis. So munis are cheap on a relative basis right now. They continue to be very high credit quality and the technicals lineup quite well. So I think those are some of the main reasons for demand into the asset class.

RICK NEWMAN: Hi, Ben. Rick Newman here. Two questions for you. First, even before the pandemic there were some concerns about Illinois' fiscal stability. What is going on there? And part of what the next stimulus bill, if it ever happens, is supposed to include is a lot of aid for states and cities. Do states and cities need that from a fiscal stability perspective? Or will they be OK without it?

BEN BARBER: It's a great question, Rick. Thank you. At the beginning of the COVID lockdown of course, liquidity got very, very difficult in the muni market and a lot of people worried about market access for municipalities overall. Soon thereafter, I think it was the end of May, the fed came up with their plan called the MLF, the Municipal Liquidity Facility, which really bolstered the municipal market and the liquidity thereof. So that overall program has a capacity of \$500 billion dollars. It's been in existence since late May and only a billion seven of that has been tapped so far. One of the issuers was Illinois, the second was the New York MTA, Metropolitan Transit Authority.

So market access is quite good and remains very, very strong in munis. I think the MLF, the Municipal Liquidity Facility, would be viewed already as a success, even though hardly any municipal issuers are tapping into it. And I think it's just by virtue of the fed offering that, that really helped market liquidity quite a bit. I think that your question specifically about Illinois and other issuers that are having more trouble from a credit fundamental perspective is spot on. And I think the market is very well attuned to those risks. The muni market is pretty good at penalizing the bad actors in our market and rewarding the good in terms of credit spreads and the levels at which these different issuers trade in the marketplace. So it's not lost in the market that Illinois is going through tremendous pressure over the last three, four, five years. But in those pressures can come opportunities, and that's what we on the research side of the municipal bond market at Franklin Templeton really, really seek to dig into.

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