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[Muni Bonds Battered by Covid Rally With Market Eyeing Recovery.]

- **Junk-bonds backed by airlines see month's biggest gains**
- **New Jersey deficit bonds jump after debt sale last week**

Some of the $3.7 billion of bonds New Jersey sold last week to plug the budget shortfalls caused by the economic slowdown have gained in secondary trading, driving the yields on 12-year securities to as little as 1.75%. Bonds issued by New York's Metropolitan Transportation Authority have been little changed despite the escalating cash squeeze caused by the drop in subway and bus ridership. Even junk debt backed by airlines has surged, delivering bigger gains this month than any other high-yield sector, according to Bloomberg Barclays indexes.

The shift has been driven by encouraging news around three Covid-19 vaccines and signs that states and local governments' tax collections haven't been hit as badly as anticipated, in part because of federal aid.

"The best news muni credit has heard in a long time is this vaccine news the last couple of weeks," said Thomas Graff, head of fixed-income for Brown Advisory, which oversees $4 billion of municipal debt and has bought bonds sold by the MTA and airports.

The shift in sentiment shows that investors are starting to focus more on the long term even with the virus currently raging and uncertainty about whether Congress will enact an economic stimulus bill before President-elect Joe Biden takes office on Jan. 20.

High-yield municipals, which finance everything from malls to senior living spaces, could be big winners from the vaccine. Bank of America Corp. strategists said in a report Friday that they're moving to a "market weight" on high-yield municipals, forecasting returns of 7% because of the more optimistic outlook.

Lind Capital Partners, which invests in high-yield debt, said in a note to clients that parts of the market, like higher education, had fallen more since March than was justified.

With the promising news about vaccines, junk-rated municipal bonds backed by airlines have rallied, driving an index of them to a gain of 3.28% this month, more than any other segment of the high-yield market. The yield on some Delta Air Lines Inc. muni debt due in 2045 has dropped to 3.5%, down from 4.55% when the debt was sold in September.

Burton Mulford, a portfolio manager at Eagle Asset Management, said his firm is buying bonds issued by large airports and large, multi-site hospital systems that were stung during the pandemic.

"There certainly is light at the end of the tunnel," he said.

Not all segments of the muni market will be completely out of the woods with a vaccine or an economic recovery. For state and local governments, the financial pain from Covid-19 may not be over yet given that tax collections tend to remain depressed well after recessions end.

UBS Global Wealth Management cautioned clients on being too exuberant about the vaccine, noting that they expect more credit-rating downgrades than upgrades in the muni market next year. And Morgan Stanley strategists said in a report last week that the firm is more cautious on local governments even if Congress delivers aid to cover their budget shortfalls.

Yet even after a credit-rating downgrade and as Covid-19 cases spike in the Garden State, New Jersey had little trouble borrowing. Its bonds priced at lower yields than initially marketed to investors, with those due in 2032 yielding 2.25%. It fell as low as 1.82% Monday.

Graff, the investor with Brown Advisory, said he's more cautious on financially-teetering local governments given it could take time to recover from the impact of public health shutdowns. There are also longer-term concerns facing the continuing-care retirement sector, which also raises funds in the muni market and has been hard hit by the virus.

But more broadly, he's upbeat and says more buyers in the market are, too.

"People are inching their way in," he said. "There's still a lot of hesitancy, but it's turning around."

Bloomberg Markets

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November 23, 2020, 10:38 AM PST