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Why a Pullback Could Still Prove Inviting for Municipal Bonds.

Municipal bonds are languishing amid the recent spike in Treasury yields, but that selling pressure could bring opportunities with exchange traded funds like the iShares National Muni Bond ETF (NYSEArca: MUB).

MUB seeks to track the investment results of the S&P National AMT-Free Municipal Bond IndexTM. The fund generally will invest at least 90% of its assets in the component securities of the underlying index and may invest up to 10% of its assets in certain futures, options and swap contracts, cash, and cash equivalents. The index measures the performance of the investment-grade segment of the U.S. municipal bond market. Municipal bonds give debt market investors an extra layer of safety given that local government debt typically has a lower rate of default compared to corporate bonds.

"Municipals struggled throughout the month of February, posting their worst month of performance since the pandemic-induced selloff in March 2020," according to BlackRock research. "The S&P Municipal Bond Index returned -1.36%, driven by rising interest rates resulting from improved COVID metrics, expectations for additional fiscal stimulus and continued easy monetary policy, and optimism for the U.S. economy. Municipals underperformed Treasuries as historically rich valuations recalibrated and municipal-to-Treasury ratios re-set from their recent all-time tight levels."

A Good Time to Revisit MUB?

Municipal bonds have long been considered some of the most reliable fixed income options. Enter Covid-19 and a once untouchable space could now be in jeopardy with defaults. Nevertheless, MUB and friends are proving steady amid a spate of new issuance.

"Issuance was modestly elevated in February at $33 billion, 22% above the 5-year average. Initial primary market strength faded mid-month as the emergence of risk-off sentiment and elevated secondary trading weighed on new issues, causing underwriters to show more flexibility in both structure and pricing. The average rate of oversubscriptions fell dramatically from 8.0x during the first half of the month to just 2.4x in the second half," notes BlackRock.

Higher issuance isn't always a drag on assets such as MUB. In fact, there some sound fundamental factors in the ETF's favor.

"We maintain a cautious but constructive view on the asset class," adds BlackRock. "While the month of March has been a historically weak seasonal period for muni bonds and we expect rate volatility to continue, the considerable re-set of valuations has created a better backdrop for the municipal market, assuming recent performance weakness does not drive a prolonged outflow cycle. Additionally, given our view that markets tend to overcorrect, a continued selloff could create an attractive buying opportunity."

ETF TRENDS

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MARCH 9, 2021