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BlackRock: Infrastructure Spending Will Continue To Be A 'Ballast' for Municipal Bonds

BlackRock Municipal Bonds Group Head Peter Hayes joins Yahoo Finance to explain the municipal bonds outlook.

Video Transcript:

EMILY MCCORMICK: Welcome back to "Yahoo Finance Live." US Treasury Secretary Janet Yellen doubled down on her support for President Joe Biden's infrastructure investment plans in an op-ed published to Yahoo Finance earlier today. The plans include the $1 trillion infrastructure bill passed by the Senate last week, and the $3.5 trillion budget plan to expand the social safety net, which the Senate also approved the blueprint for last week. Here to discuss infrastructure, the outlook for the Fed, the markets and more is Peter Hayes, BlackRock's Municipal Bonds Group Head.

And Peter, I want to start off with that op-ed and those remarks from Janet Yellen. She highlighted several points to make the case for the spending now. And from your vantage point, how could investors be thinking about municipal bonds, specifically as a way to trade this increased government spending?

PETER HAYES: I think in general, first of all, thanks for having me, great to be back. I'll say that in general, there's been an awful lot of stimulus since the start of the pandemic on the part of both the Fed and Congress. And this is just another element. So I think it probably gives a tailwind to assets in general. But certainly adds a big balance to the municipal bond market. When you think about the spending that's occurred at the state and local level, it's been really beneficial on top of actually surprisingly strong tax revenues that have occurred.

Remember, most states and cities were really talking about large budget deficits, and actually what we've seen, is large budget surpluses. I think I saw today where the state of New York, their July revenue collections are up 21% from a year ago. New York City, 14%. Many states have not even touched these billions of dollars that they've received from the federal government. So all of this investment, all of this infrastructure spending will continue to be a ballast I think to the economic environment and the municipal market going forward over even, probably the next two years.

ADAM SHAPIRO: Peter, it's always good to see you. When we talk about going forward, I realize that you and the team, the bonds group deal in much larger numbers, but I'm going to ask a question from the kind of perspective of a lot of people who might be 45 years and older looking at the future. If they had say $500,000 saved up for retirement, how do you advise them?

Because it used to be a chunk of that you might want to put into municipal bonds. And you noted in the note that 27% of the supply was taxable issuance, because we're seeing the refinancing of what had been tax exempt muni bonds by cities and municipalities into taxable. What would you say to that potential woman or man regarding the future for them?

PETER HAYES: I'd say a lot of it is around, how much do you want to protect from taxes? And that's one of the reasons we've seen such strong inflows into the asset class this year. We've seen $62 billion in mutual fund inflow. So that's about the strongest that I can remember going back into the '90s. And I think a lot of that is because the fear of taxes going up. Now it's likely that the marginal tax rate for individuals, perhaps it goes back to 39.6%. So the benefit there is somewhat incremental. I think the bigger fear is corporate taxes. But clearly, for that individual looking to shelter income and not pay taxes on that income, municipal bonds will continue to provide, I think will provide that benefit.

The other element that sometimes is forgotten, is you look, if you think interest rates are going to rise, municipal bonds tend to do better. Well, look at this year. Year to date, the municipal index is up 1.6%. Most fixed income asset classes are actually negative. We'll use the Barclays ag. That's down negative 70 basis points. So a fair amount of outperformance. But it provides you some insulation if you really believe interest rates are going to rise.

And the other one is, it's a great hedge against equity risk. It's always done very well when you see volatility in the equity markets. Municipal bonds tend to be a safe haven for that. So it's really got kind of a three-pronged benefit to that investor, and that's what I would tell them. Adam.

ADAM SHAPIRO: In fact, the S&P municipal bond index, to reiterate what you said, has you said in the note, year to date, total return of about 1.9%, almost 2%. The other thing that's great about your note, is how everything is connected. You talk about climate change impacting revenue to utilities, especially the water utilities. Out West, which are now going to have to restrict demand, and you ended that part of the note by saying, we anticipate water usage limitations will become stricter and more widespread through year end. What kind of pressure does that put on the utilities to make good on their notes? I don't think anyone's going to default, but does it put pressure on them?

PETER HAYES: Well, I'll start with your comment. No one's going to default. I think that's very important. Sometimes they see these headlines and they think that means that an issuer is not going to repay their debt. That's never happened. California in particular has had a long history of drought. And even, and you look in some other areas of the US where droughts have been an issue over the years, water utility systems have always been very resourceful. They could cut water usage, they could raise rates. There's a lot of ways that they can actually utilize to repay their debt.

And the other one is just general utilities. So you talk about A, water restrictions. We saw I think in the Southwest yesterday for the first time they're going to cut the water usage in the Southwest to the Colorado River. And then the other is just general utilities. We saw today where I think PG&E is going to basically cut power to a certain part of their population in Northern California. That can impact revenues in the utility sector.

But again, they have a lot of tools at their disposal that they can ultimately use to help repay the debt. So it's not a default issue. Sometimes it's a rating issue, but it hasn't even really been that. Sometimes they go on negative watch, but again, investors shouldn't be necessarily very concerned about that on a going forward basis.

ADAM SHAPIRO: Peter, just quickly on interest rates. What are you expecting from the Fed meeting minutes tomorrow and Jackson Hole next week? When do you expect that tapering announcement and the actual start of tapering?

PETER HAYES: That's the $64,000 question that the bond market I think would love to know. I think our feeling generally is that interest rates have to rise. When you look at the, something you asked at the outset about the economic stimulus that's occurred, when you look at some of the supply chain disruptions and you look at the impact it's had on inflation, the notion that it's transitory is probably under, I think probably overvalued to some degree. This is here to stay for a while. So interest rates have to rise. It's a matter of when, and that goes to your question.

I think Jackson Hole is going to be somewhat of a non-event. I think the market may be expecting more out of Jackson Hole. Probably not likely to see anything there. I think it's more likely to occur in the coming months after that when we get by this Delta variant. The Fed wants to see what the impact will be on the economy. And then I think if we can get through that, if there's some clarity around the booster, and is a 2022 to restart to the economy, then you have to think more seriously about the Fed tapering, beginning to raise short-term interest rates, all of which are more likely to occur in 2022.

ADAM SHAPIRO: Peter Hayes, BlackRock Municipal Bonds Group Head, thank you so much.

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