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Citigroup Sees Pain for High-Yield Munis After Nuveen Shuts Fund.

- **Fund manager plan to close to new money may signal overheating**
- **Citi sees high-yield muni spreads widening, valuations falling**

The riskiest part of the \$4 trillion municipal bond market may see demand fade as the largest fund devoted to buying that debt closes its doors to new investors, according to Citigroup Inc. strategists.

Nuveen's plan to limit new money in its high-yield muni fund signals to investors that the market for riskier tax-free bonds may be overheating, strategists led by Vikram Rai wrote this week, in a report that doesn't mention the asset manager by name.

In addition to the signaling effect, Nuveen's fund accounts for almost a fifth of the assets under management by high-yield muni asset managers, according to Citigroup. Even if existing holders keep adding money, and new investors hand their dollars over to other firms, the fund is big enough to have an impact on the overall market as its demand slows.

"You can expect spreads to cheapen because one, people will buy less and secondly the largest mission fund manager will also buy less," Rai said in an interview.

The strategists estimate that the Nuveen fund's demand for new securities will drop by about 50%. But it's unusual for muni funds to close their doors to new investors, so it's hard to know what the net decline will be for demand overall in the market as at least some investors pour money into other funds, they wrote.

In addition to high-yield municipal bonds getting weaker relative to Treasuries, valuations will likely fall overall, Rai wrote. Any declines would come after the securities lost 0.2% in August on a total return basis, the first monthly decline since February, according to a Bloomberg index. The debt has still gained 7.2% this year.

Nuveen said last month that its High Yield Municipal Bond Fund, run by John Miller, plans to close to new investors at the end of September. It has returned around 15% over the past year, better than all but 2% of its peers, according to data compiled by Bloomberg.

Junk and unrated munis can fund a range of issuers, including airline-linked projects and convention centers. Investors have poured nearly \$18 billion into funds buying these securities this year, as an improving economy and federal bailouts for state and local governments have made many fund buyers more willing to take risk.

Meanwhile, there are only so many opportunities to buy high-yield muni bonds now, Citigroup strategists wrote, noting "demand far exceeds supply." Buying investment-grade securities would depress returns for these funds.

Nuveen's move came after Invesco in May said it was closing its high-yield muni fund to new

investors.

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