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JPMorgan Sees Muni Housing Bonds Besting Other Sectors Next Year.

- **Muni housing bonds outperform during rising-rate environment**
- **Debt offers higher yields, less volatility, says strategist**

Municipal-bond investors seeking shelter from rising rates in 2022 should look to housing bonds, according to JPMorgan Chase & Co.'s lead muni strategist.

Debt issued by states to finance low-interest loans for first-time home-buyers or build affordable housing carry higher yields and are less volatile, so they typically perform better than other muni sectors when rates rise, said Peter DeGroot, head of municipal research and strategy at the biggest U.S. bank.

Housing bonds rated AA and A provide an average extra yield of 11 to 35 basis points over similarly rated revenue bonds to compensate for uncertainty about how quickly homeowners will pay off their mortgages and because investors demand a premium for liquidity, according to JPMorgan. The relatively higher yields of housing bonds and their propensity to trade less frequently reduces the securities' volatility.

Planned Amortization Class bonds, debt with structural features that reduce the likelihood of early principal payments and price like shorter-dated securities, are the best candidates to outperform, DeGroot said.

"Housing bonds have performed extraordinarily well in rising rate environments," he said.

To cool the hottest inflation in a generation, Federal Reserve officials could raise interest three times next year, and many investors are anticipating the first hike around midyear. The rapid spread of the omicron variant and the risk that sustained inflation could bring faster-than-expected interest rate hikes could make the new year volatile.

DeGroot's research found that housing bonds outperformed the overall market during four cycles when investors pulled cash out of bonds: the pandemic shock of March 2020; a protected period of rising long-term Treasury yields in 2018; the "Taper Tantrum" in 2013; and Meredith Whitney's prediction of "hundreds of billions of dollars" of municipal bond defaults in 2010.

From May 22, 2013, when former Fed Chair Ben Bernanke jarred bond buyers by saying the Fed would start scaling back asset purchases — to when yields peaked on Sept. 6, investment grade municipal bonds lost 6.2%, according to the Bloomberg Municipal Bond Index. By contrast, muni housing bonds lost 4.6% over that period.

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By Martin Z Braun

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