

Muni Fortnightly

Treasury yields break lower on Turkish currency boil over. Muni yields rally lags. Puerto Rico COFINA bonds strongly rally on bondholder restructuring agreement.

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Bottom Line:

- Treasury yields were range bound till Turkish currency concerns allowed for a risk-aversion rally.
- Muni yields follow Treasuries but lag.
- Muni market size stagnates.
- Puerto Rico COFINA bond holders strike an agreement for recovery but other creditor and PROMESA approval is required. Bonds rally significantly.
- S&P Puerto Rico Total Return Index was +3.0 last week; 25.2% YTD.

What Happened in the Bond Markets Last Week?

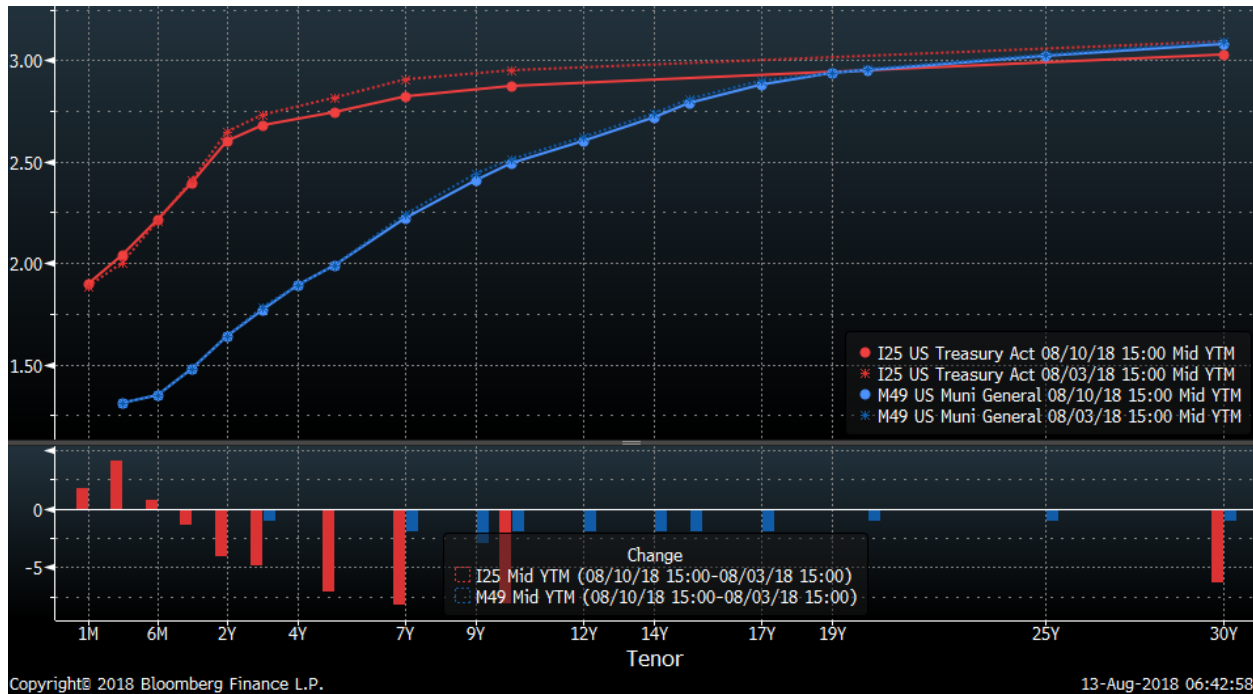
- Treasury yields, last week, mostly bounced around within a narrow range until later on Thursday and in particular on Friday. An extremely out of the context yield prognostication by a high-level bank executive and a Twitter-driven auto company secured-funding go-private claim entertained the market for a few days while there were really no economic data of consequence to otherwise influence changes. Equities used the opportunity to rise and the VIX used the opportunity to hit the lows last seen in January. The trade-tariff serve n' volley effect has seemingly lost its efficacy within the markets. However, as it simmered in the background early in the week, Turkish currency boiled up on Thursday (as a manifestation of its monetary policy and fiscal condition) and then boiled over on Friday (off 35% in one week's time) causing a safe-haven rally allowing Treasury yields to break lower, out of its range. Inflation data, which were the only economic data of consequence for the week, were much as expected and much less than alarming.
- Municipal bond yields stayed tethered to Treasuries until Friday when they did not keep pace with the Treasury rally resulting in higher (cheaper) ratios.

Yields (Figure 1):

- For the week ending 8/10/18 Treasury yields were lower across the curve; 2-year Treasury Note yields were -1.4 bps at 2.60%, 5-year Notes yields were -7.1 bps at 2.75%, 10-year Notes yields were -8.1 bps to 2.87% and 30-year bonds yields were -6.4 bps at 3.03%.
- Bloomberg Municipal Index curve yields were slightly lower; AAA-rated GO yields; 2-year bonds were unchanged at 1.64%, 5-year bond yields were unchanged bps at 1.99%, 10-year bond yields were -2 bps to 2.51% and 30-year bonds were -5.1 bps to 3.09%.

- The Ratio of 10-year AAA GO debt to 10-year Treasury yields cheapened to 86.7 from 85.2 last week. The year-to-date average is 85.3 and the 12-month average is 85.5.

Figure 1 - Yield Curve and Muni Curve Changes – Data Source: Bloomberg



One can observe these changes by looking at how rates have changed along the curve for both the Treasury curve and for the AAA-rated G.O. Index since last week. The top panel shows four yield curves; two for the Treasury curve (in red) - one for the most current date and one from last week and two for the AAA-rated G.O. (in blue) - current and last week. The bottom panel of the graph shows changes in the rates along both curves for the week for both Treasuries and the AAA G.O. Index.

Figure 2a - Muni Ratio – Data Source: Bloomberg

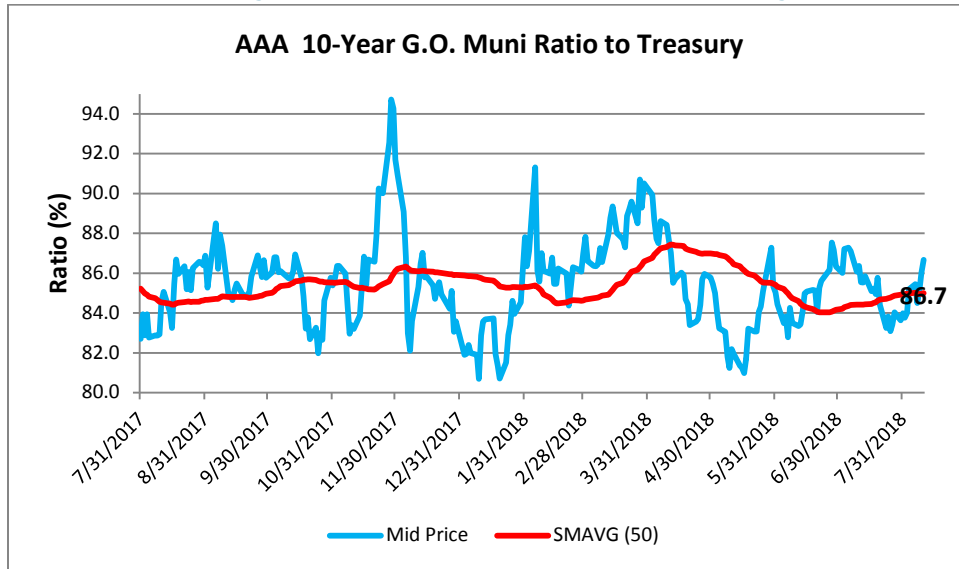
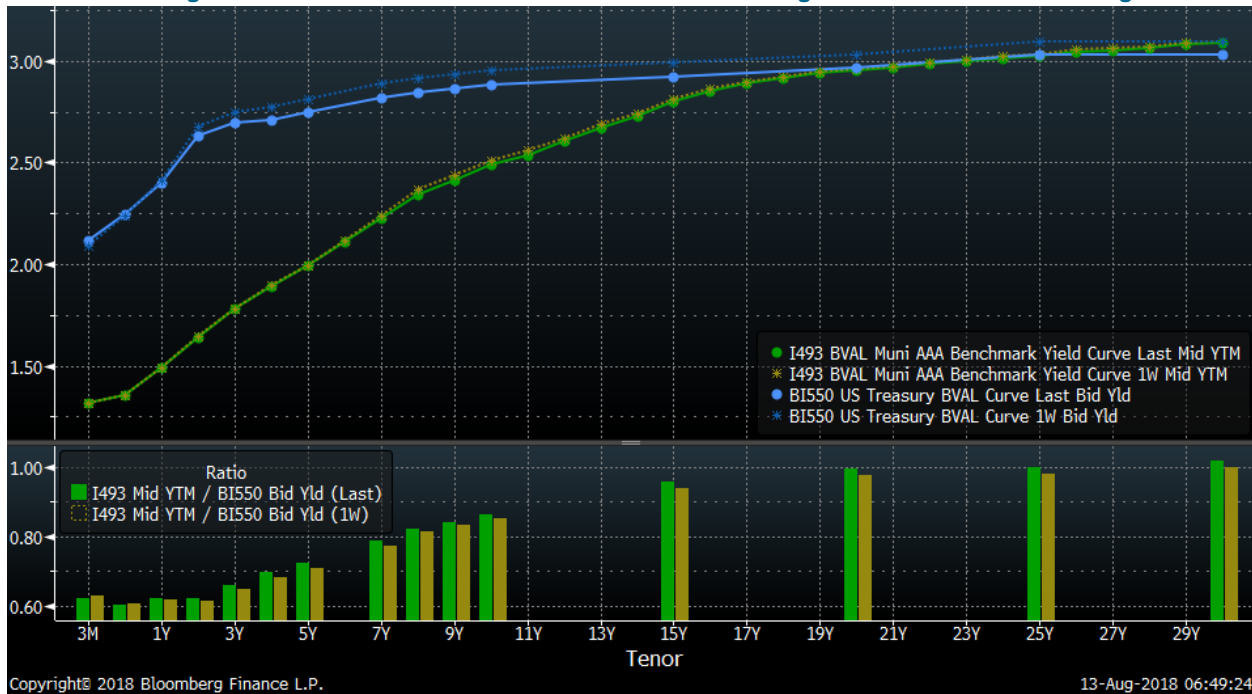
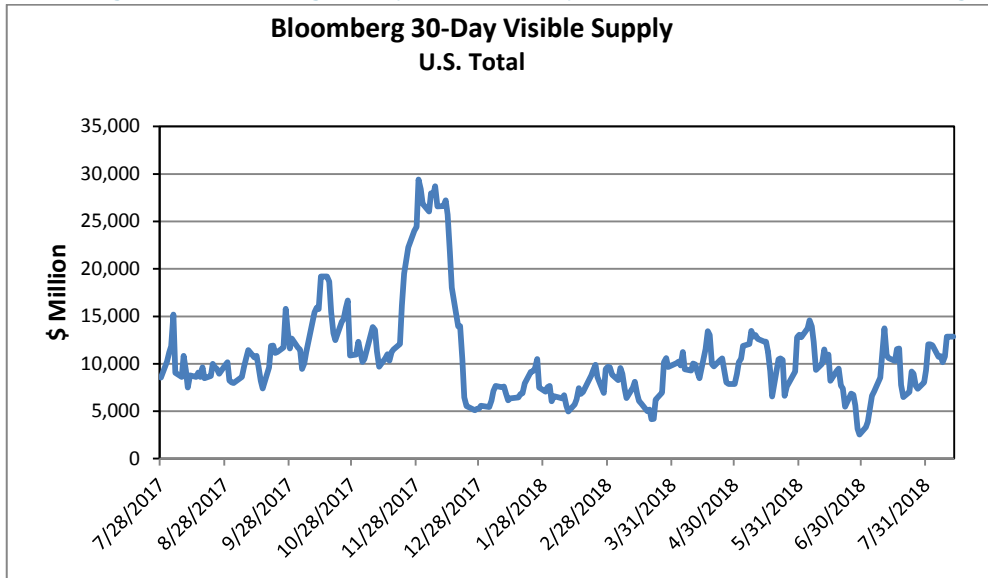


Figure 2b - Muni Ratios Across the Curve: 2-week Change – Data Source: Bloomberg



Supply (Figure 3) – Bloomberg 30-Day Visible Supply currently stands at \$12.9 billion up from \$10.7 billion this time last week. The YTD average visible supply is \$8.9 billion and the 12-mo average is \$10.7 billion.

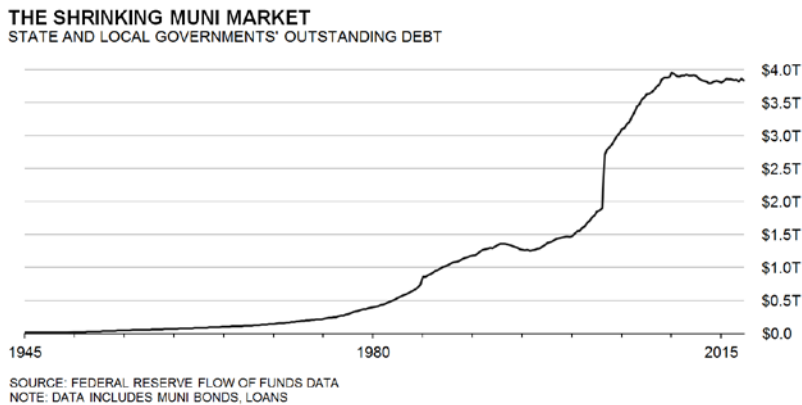
Figure 3- Bloomberg 30-Day Visible Supply - 1 Year; Data Source: Bloomberg



Articles of Interest

Municipal Fund Flows: According to Lipper data muni funds reversed back into inflows last week with \$622.6 million after the previous week's outflow of \$368.4 billion; the four-week average is a positive \$516 million. ETFs had net inflows as did high-yield funds.

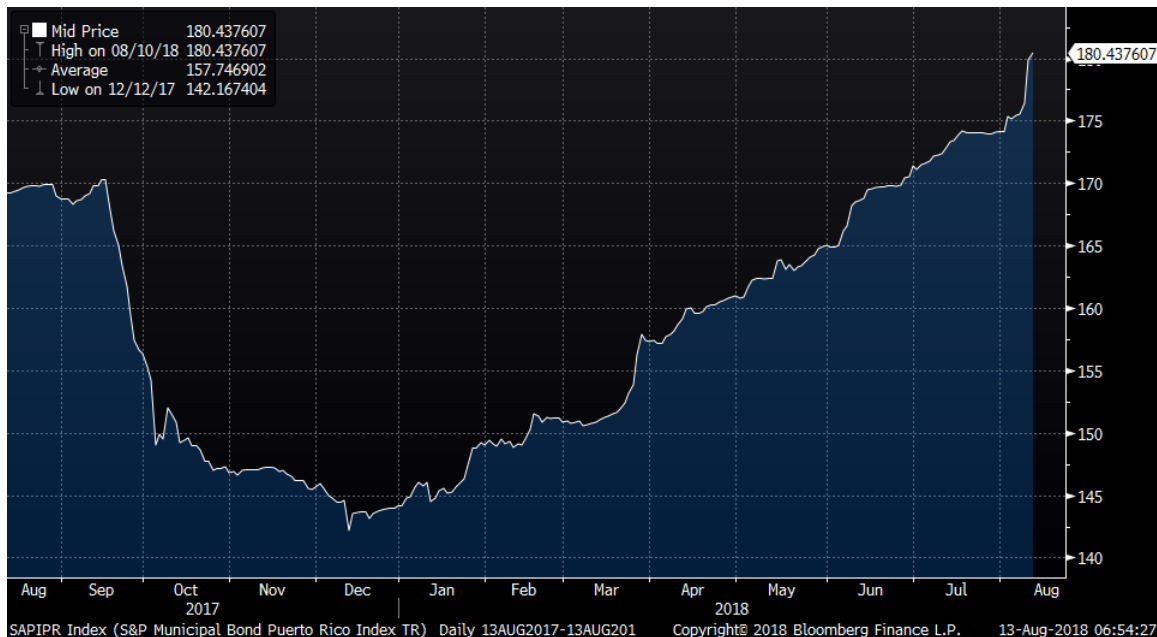
Muni Market Outstanding Debt Stagnation (Bloomberg Brief): Up until the financial crisis period, after which government austerity (at the municipal level) has lingered, the municipal bond market had been on a steady trajectory higher. In '09 and '10 issuance rose as a result of Build America Bonds program. But in '11, '12 and '13 the size of the municipal market actually shrank before rising to \$3.8 trillion in '14. The market size has remained stagnant since then (\$3.86 trillion in 2017). In 2018, new supply issuance has declined by 15%.



Puerto Rico:

- **COFINA- Debt Restructuring Deal Reached:** A restructuring of debt issued by COFINA – sales tax revenue bonds was tentatively reached amongst the majority of COFINA bondholders, as reported by the Puerto Rico Oversight Board (PROMESA). It is noted that not all bondholders were “present” and will ultimately get to vote in bankruptcy proceedings. General Obligation Bondholders and the Unsecured Creditors Committee have yet to approve the deal. As it stands, owners of subordinated debt will recover 56% of par while senior bondholders would recover 93% of par. Current bondholders would give up existing bonds for new bonds with different maturities (ranging from 2028 through 2043) and coupons (ranging from 4.3% to 4.6% and capital appreciation bonds at 5.5%). COFINA bonds rallied significantly (as an example 2040 maturity senior bonds rallied to 89.5). It is noted that this deal is not final and bondholders should recognize that terms can change and that they will receive official notice of the restructuring terms.
- **The S&P Municipal Bond Puerto Rico Index** finished at 180.4 on Friday vs. 175.2 at the end of the previous week, +3.0%. Year-to-date the index is +25.2%.

S&P Municipal Bond Puerto Rico Index Level (1-year)

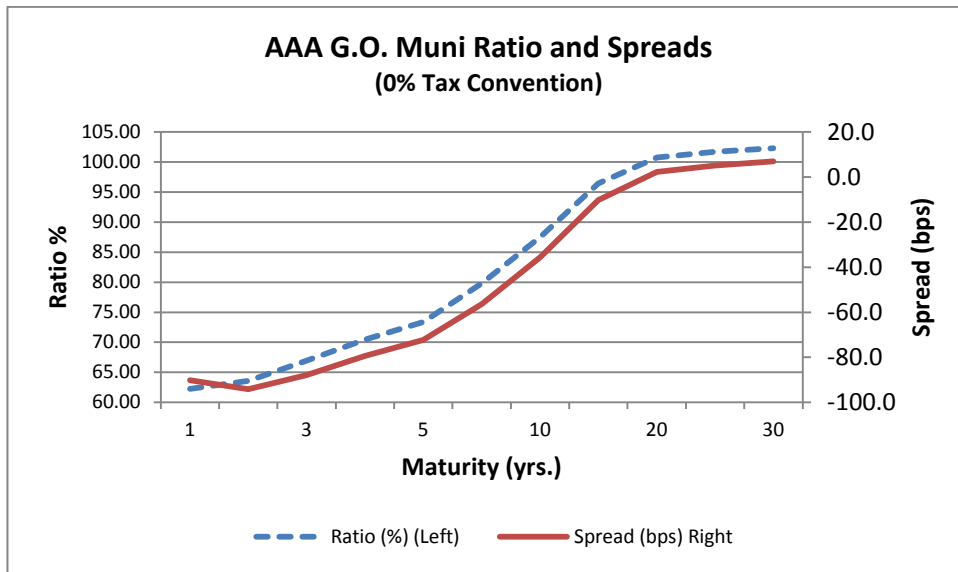


Relative Value by Maturity

Table 1 - AAA Muni Ratios and Spreads by Maturity - Data Source: Bloomberg

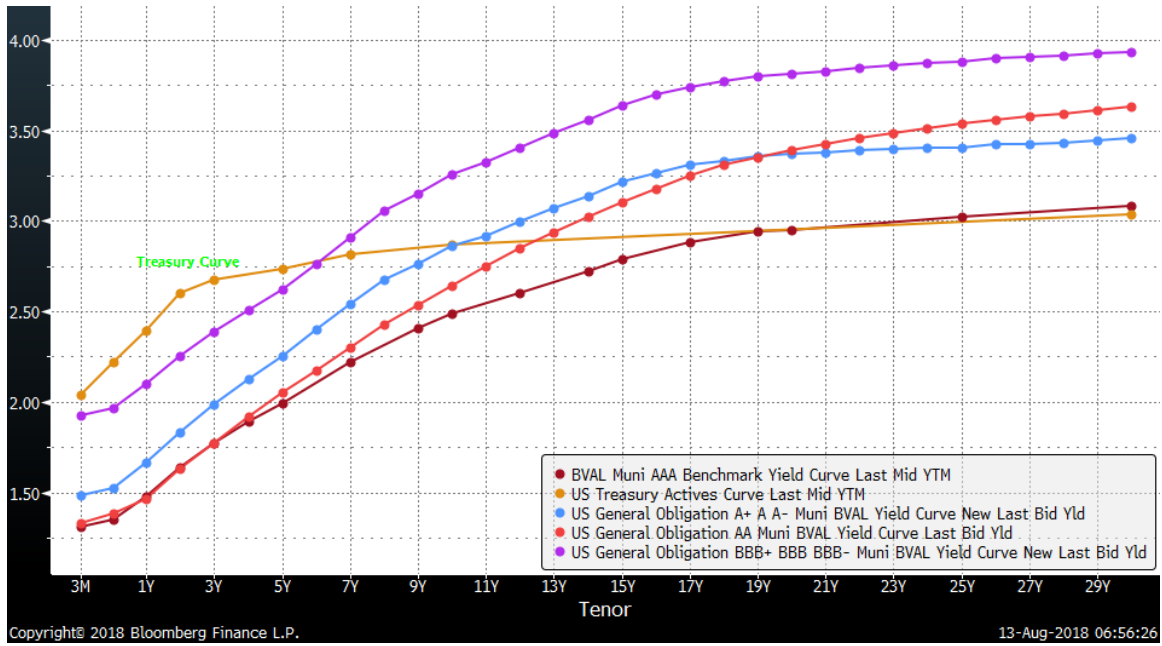
8/13/2018	Yield-to-worst (%)		0% Tax Rate		35% Tax Equivalent	
Maturity (yrs.)	AAA Gen. Oblig.	Treasury	Spread (bps)	Ratio (%)	Spread (bps)	Ratio (%)
1	1.49	2.39	-90.2	62.3	-10.1	95.8
2	1.64	2.58	-94.2	63.6	-5.7	97.8
3	1.78	2.66	-87.9	66.9	7.8	102.9
4	1.89	2.68	-79.3	70.4	22.5	108.4
5	1.99	2.71	-72.3	73.4	34.9	112.8
7	2.23	2.79	-56.3	79.8	63.6	122.8
10	2.49	2.85	-35.7	87.5	98.4	134.6
15	2.80	2.90	-10.3	96.5	140.4	148.4
20	2.96	2.93	2.3	100.8	161.4	155.0
25	3.03	2.98	5.1	101.7	168.0	156.5
30	3.09	3.02	7.0	102.3	173.2	157.4

Figure 4 – AAA General Obligation Ratios and Spreads – Data Source: Bloomberg



Relative Value by Rating

Figure 5 – Muni Index Yield Curve by Credit Rating – Data Source: Bloomberg



For more information please contact your Financial Advisor.

Appendix – Important Disclosures

Some of the potential risks associated with fixed income investments include call risk, reinvestment risk, default risk and inflation risk. Additionally, it is important that an investor is familiar with the inverse relationship between a bond's price and its yield. Bond prices will fall as interest rates rise and vice versa.

When considering a potential investment, investors should compare the credit qualities of available bond issues before they invest. The two most recognized rating agencies that assign credit ratings to bond issuers are Moody's Investors Service ("Moody's") and Standard & Poor's Corporation ("S&P"). Moody's lowest investment-grade rating for a bond is Baa3 and S&P's lowest investment-grade rating for a bond is BBB-. Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest).

The Bond Buyer 20-Bond Index consists of 20 general obligation bonds that mature in 20 years. The average rating of the 20 bonds is roughly equivalent to Moody's Investors Service's Aa2 rating and Standard & Poor's Corp.'s AA. The Bond Buyer 11-Bond Index uses a select group of 11 bonds in the 20-Bond Index. The average rating of the 11 bonds is roughly equivalent to Moody's Aa1 and S&P's AA-plus. The Bond Buyer Revenue Bond Index consists of 25 various revenue bonds that mature in 30 years. The average rating is roughly equivalent to Moody's A1 and S&P's A-plus. The indexes represent theoretical yields rather than actual price or yield quotations. Municipal bond traders are asked to estimate what a current-coupon bond for each issuer in the indexes would yield if the bond was sold at par value. The indexes are simple averages of the average estimated yields of the bonds, are unmanaged and a direct investment cannot be made in them.

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