Treasury yields ended the week higher amongst global risk tolerance. Muni yields underperform on shortest end of the curve and 10yr muni yields hit highest level since 2014. Bank muni bond ownership slips some more. COFINA nearing agreement for restructuring.

**Bottom Line:**
- Treasury yields
- Muni yields underperformed Treasuries inside 2 years but otherwise follow. 10yr muni yields at highest since February 2014.
- Muni fund flows back to inflows, albeit small.
- Bank ownership of munis slides some more as a consequence of tax legislation.
- Puerto Rico COFINA and cusp of potential restructuring agreement among competing creditors.
- S&P Puerto Rico Total Return Index was unchanged last week; 26.2% YTD.

**What Happened in the Bond Markets Last Week?**
- Treasury yields moved decisively higher last week. The 10yr yield which had flirted around with 3% the week before moved a little above that level on Monday before it settled back below. And then a surge move on Tuesday took it above 3.05%. Further weakness allowed it rise to 3.09% intraday on both Wed. and Thurs. before it found its ground at 3.06%. The move higher in yields occurred during a week without broadly important economic data (but tilting to positive housing data) to drive them. The move higher in yields did occur during a period of evidently global risk acceptance and despite tariff risk concerns. The steepening-rise in yields was accomplished in both real-yield and in inflation breakeven space. The market has an upcoming Fed rate hike (on Wed.) baked into the cake. The more important concern will be the reading of the FOMC tea leaves for the upcoming meetings and more immediately the December meeting for which the market already has a ~80% probability of another hike priced in.
- Municipal bond yields vastly underperformed Treasuries on the short-end of the curve (inside 2yrs) but stayed relatively close on the rest of the curve.

**Yields (Figure 1):**
- For the week ending 9/21/18, Treasury yields were higher and the curve steeper; 2-year Treasury Note yields were +2.2 bps at 2.80%, 5-year Notes yields were +5.0 bps at 2.95%, 10-year Notes yields were +6.9 bps to 3.06% and 30-year bonds yields were +7.3 bps at 3.20%.
- Bloomberg Municipal Index curve yields also moved higher; AAA-rated GO yields; 2-year bonds were +10 bps at 1.95%, 5-year bond yields were +8 bps at 2.22%, 10-year bond yields were +6 bps at 2.63% and 30-year bonds were +8 bps to 3.27%.

- The Ratio of 10-year AAA GO debt to 10-year Treasury yields was little changed at 86.0 last week. The year-to-date average is 85.4 and the 12-month average is 85.6.

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 - one for the most current date and one from last week and two for the AAA-rated G.O. - 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.
Supply (Figure 3) – Bloomberg 30-Day Visible Supply currently stands at $4.5 billion down from $7.2 billion this time last week. The YTD average visible supply is $8.8 billion and the 12-mo average is $10.6 billion.
Articles of Interest

**Municipal Fund Flows:** According to Lipper data, muni funds had $134.4 million of inflows after the previous week’s outflows of $121.9 million. ETFs and High-yield funds had net inflows.

**Bank Muni Ownership Declines (Bloomberg graph below):** According to Federal Reserve data, bank ownership of municipal bonds has declined in 2018 as a result of tax legislation which cut corporate tax rates which reduced the incentive to invest in federally tax-free investments. There have been two consecutive quarters with an aggregate decline of approx. $26.7 billion. This has occurred after eight consecutive years of additions of municipal bond holdings. Property, casualty and life insurers are now the third largest holder of munis (after individuals and funds).

**Puerto Rico:**

- **COFINA Deal Closer:** A bondholder’s agreement and support from opposing creditors (including some GO bondholders) has brought the Puerto Rico Sales Tax Revenue bond restructuring a step closer. The island’s oversight board expects the agreement, which splits sales tax revenues between COFINA bondholders and the general government, to win approval in bankruptcy court in October. If enacted the recovery for senior COFINA holders would be 93% and for subordinate holders it would be 56%.

- **The S&P Municipal Bond Puerto Rico Index** finished at 182.0 on Friday vs. 182.0 at the end of the previous week, +0.0%. Year-to-date the index is +26.2%.
Relative Value by Maturity

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

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<th>9/24/2018</th>
<th>Yield-to-worst (%)</th>
<th>0% Tax Rate</th>
<th>35% Tax Equivalent</th>
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<td>Maturity (yrs.)</td>
<td>AAA Gen. Oblig.</td>
<td>Treasury</td>
<td>Spread (bps)</td>
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Relative Value by Rating

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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