

# Muni Fortnightly

Treasury yields rose as global risk-tolerance surged despite some plateauing of economic data strength. Munis approach richest levels in a year. Barclay's Muni Index had third consecutive year of positive returns; +5.45%.

## PWM Fixed Income Research

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### Bottom Line:

- Treasury yields begin the year rising as global risky asset classes take flight. One year curve shows the magnitude of the Treasury curve bear-flattening and the outperformance of the municipal market curve.
- The 10yr AAA GO Ratio has approached the richest level in over a year.
- Bloomberg Barclay's Municipal Bond market index total return was +1.05% in December (+5.45% YTD).
- Supply falls back from late year tax reform-led surge.
- S&P Puerto Rico Total Return Index was +1.0% last week; -17.6% one year.

### What Happened in the Bond Markets Last Week?

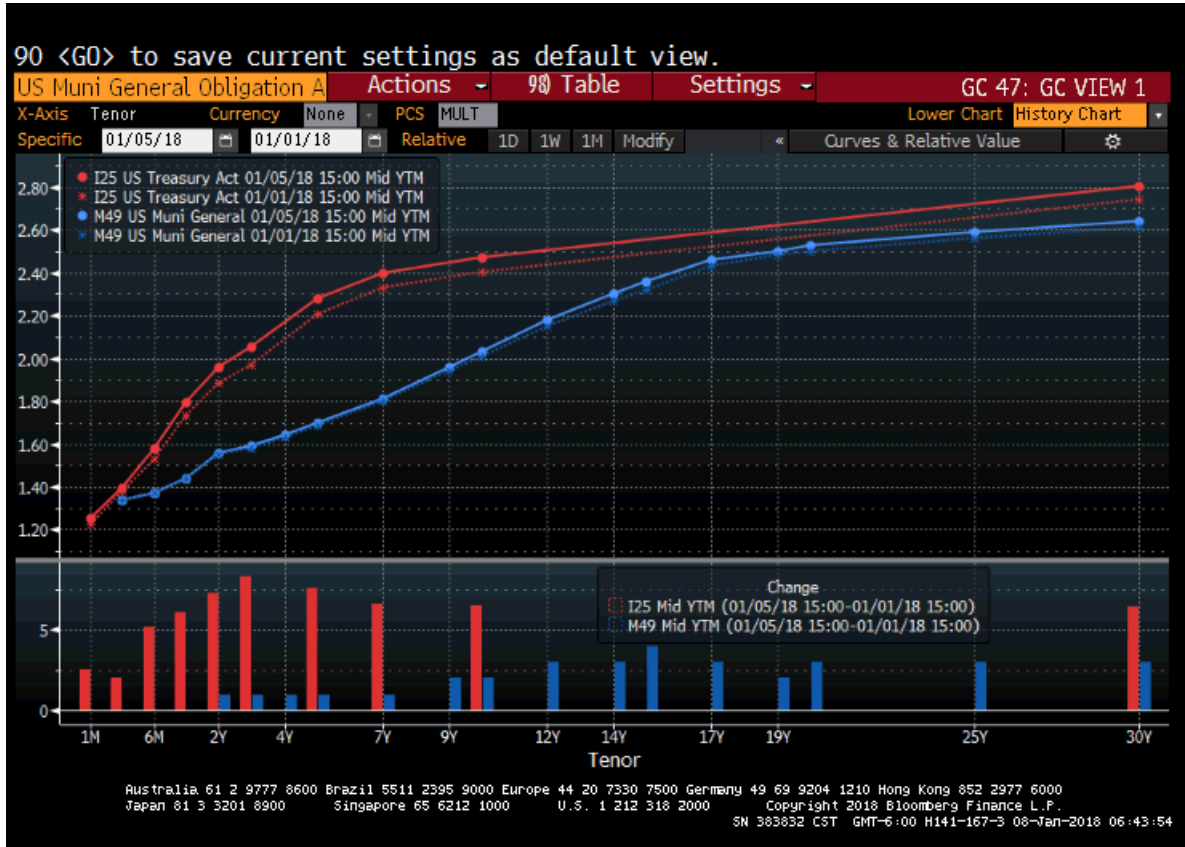
- Treasury yields staged a rare relatively non-flattening week while yields generally rose. So generally, not a great week for duration but it wasn't drastic. Demand for global risky asset classes (equity and credit) was on full display in the first week of the year thus pressuring safer assets despite some emerging plateauing, at least, in economic data. The rise in yields was primarily in inflation breakeven space and will be vetted during this week's inflation data releases.
- A one-year curve for Treasuries and Munis (AAA GO) is also shown below. The predominant takeaways from that graph are a) the bull-flattening in the Treasury yield curve (2-10's by about 80 bps) and b) the relative outperformance of the municipal yield curve (yields not rising by same magnitude). The AAA GO Ratio, at 82.2, has approached the richest levels in over a year.
- Municipal bond yields, which have been very volatile during the past month, have seemingly settled back a bit. The 10-yr AAA GO Ratio has swung from ~82 in early December to ~95 just two weeks later and all the way back down to ~85 currently.

### Yields (Figure 1):

- For the week ending 1/15/18 Treasury yields traded higher and slightly flatter; 2-year Treasury Note yields were +7.3 bps to 1.96%, 5-year Notes yields were +7.6 bps at 2.28%, 10-year Notes yields were +6.6 bps to 2.47% and 30-year bonds yields were +6.4 bps at 2.80%.

- Bloomberg Municipal Index curve yields were higher, AAA-rated GO yields; 2-year bonds were +1 bps to 1.56%, 5-year bond yields were +1 bps to 1.70%, 10-year bond yields were +2 bps to 2.03% and 30-year bonds were +3 bps to 2.64%.
- The Ratio of 10-year AAA GO debt to 10-year Treasury yields fell from week-ago levels to 82.2 from 83.6 last week. The year-to-date average is 82.1 and the 12-month average is 88.8.

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.

One-year Treasury and Muni curves:

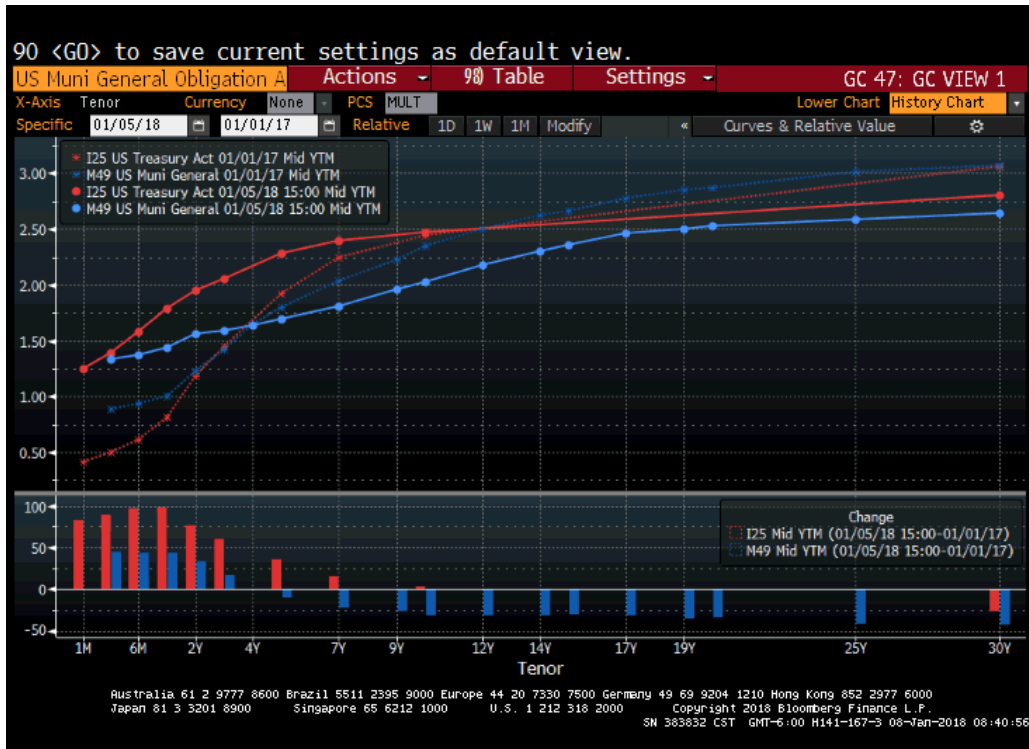
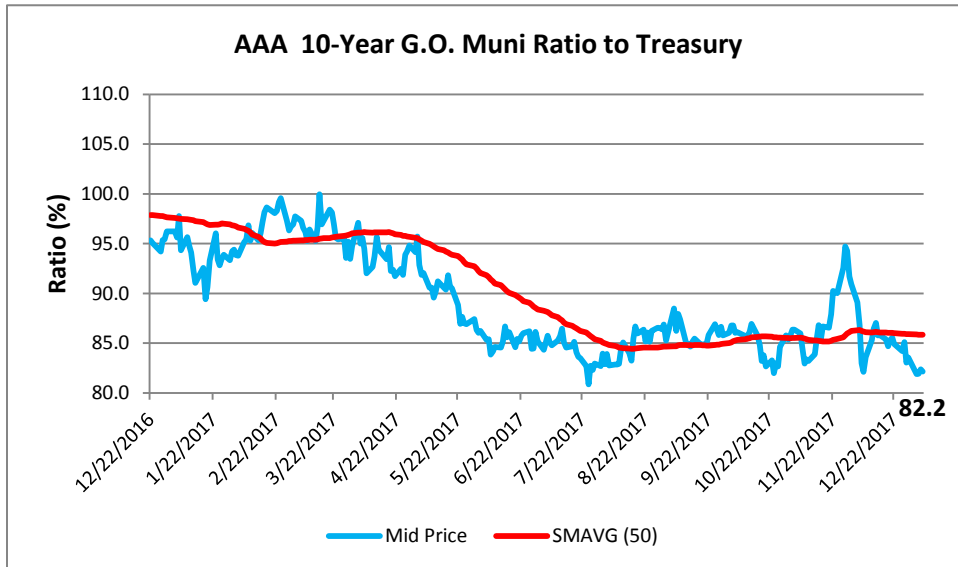
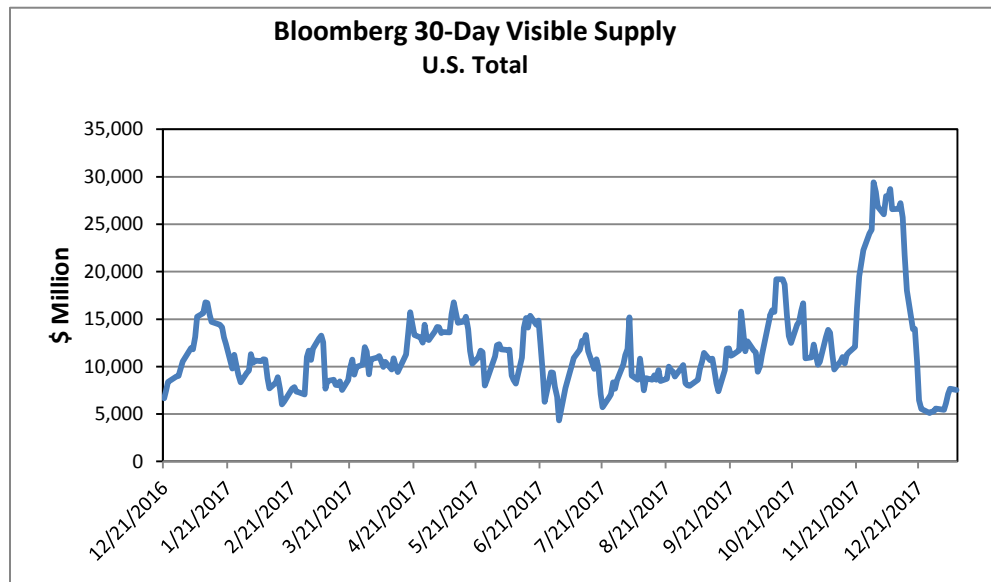


Figure 2 - Muni Ratio – Data Source: Bloomberg



**Supply (Figure 3)** – Bloomberg 30-Day Visible Supply currently stands at \$7.5 billion down from \$5.6 billion this time last year. The YTD average visible supply is \$6.8 billion and the 12-mo average is \$12.0 billion. The fall in volume is both seasonal and a drop from the surge late in the year in anticipation of potentially restrictive tax reforms.

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



**Articles of Interest**

**Municipal Fund Flows:** According to Lipper data muni funds had net outflows of \$47.9 million after \$180.2 million of net outflows during the previous week. The four-week moving average was \$59.9 million of inflows. ETFs reported net inflows for the week. High-yield funds had net inflows.

**December Municipal Tax-Exempt Performance:**

- Bloomberg Barclay’s Municipal Bond Index had a +1.05% total return in December and outperformed the Treasury Index (which returned 0.31%). The positive municipal index return comprised of a price return of +0.70% and a positive coupon return of +0.35%. Through December, the year-to-date total return is +5.45% and the last 12-months’ total return is +5.45%.
  - The ending Yield-to-Worst (YTW) for December was 2.36% (-11 bps) with a 5.1 modified duration-to-worst.

- The *General Obligation Index* had a +1.01% total return in December. Through December GOs had a +5.24% total year-to-date and +5.24% during the last 12-months.
  - The YTW at the end of December was 2.26% (-12 bps).
  - The *State General Obligation* sub-index had a +0.87% total return in December, with a +4.72% total return year-to-date and a 12-month total return of +4.72%.
    - Notable geographic indexes' December returns include; *Laggards* – Puerto Rico (-0.74%), Virgin Islands (+0.43%) and CT (+0.63%); *Leaders* – Guam (+1.95%), SD (+1.53%), AL (+1.45%). Other notable jurisdictions; AZ (-0.66%) CA (-0.54%), CT (-0.57%) FL (-0.61%), IL (-0.34%), IA (-0.63%), KS (-0.68%), MI (-0.51%), MN (-0.79%), NJ (-0.30%), NY (-0.57%), OH (-0.50%), OR (-0.75%) PA (-0.31%), Puerto Rico (-0.96%), TX (-0.58%), WA (-0.66%), WI (-0.68%).
    - The ending YTW for the State G.O. sector was 2.21%.
  - The *Local General Obligation* sub-index had a +1.17% total return in December, with a 5.85% total return year-to-date and the 12-month total return of +5.85%.
    - The ending YTW for the Local G.O. sector was 2.33%.
- The *Revenue Bond Index* had a +1.14% total return in December, with a year-to-date total return of +6.00% and a 12-month total return of +6.00%.
  - The best performing revenue sectors in December were hospitals (+1.28%), education (+1.25%) and water & sewer (+1.16%).
  - The laggard revenue sectors were resource recovery (+0.87%), housing (+0.97%), and leasing (+1.03%).
  - The ending YTW for the Revenue sector was 2.48%.

The returns across maturities for the Barclay's Muni indexes were; 3-yr +0.22%, 5-yr +0.46%, 10-yr 1.20% and 20-yr +1.47% reflecting the flattening in the Treasury curve.

**Tax Law May Drive High-Tax States to Benefit by Greater Demand (Bloomberg Brief):** The new tax law which limits the ability of households to deduct state and local taxes to \$10,000 may drive incremental demand for bonds that are exempt from state taxes. This may be particularly the case in high-tax states. NY, NJ and CA have some of the highest local tax burdens in the country.

### **Puerto Rico:**

- **GOs Miss Interest Payments:** Puerto Rio GO's which have defaulted beginning in 2015 continued its streak into 2018 as Jan. 22<sup>nd</sup> interest payments were skipped once again.
- **The S&P Municipal Bond Puerto Rico Index** finished at 145.6 on Friday vs. 144.2 at the end of last week, +1.00%. Year-to-date the index is 1.00%.

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

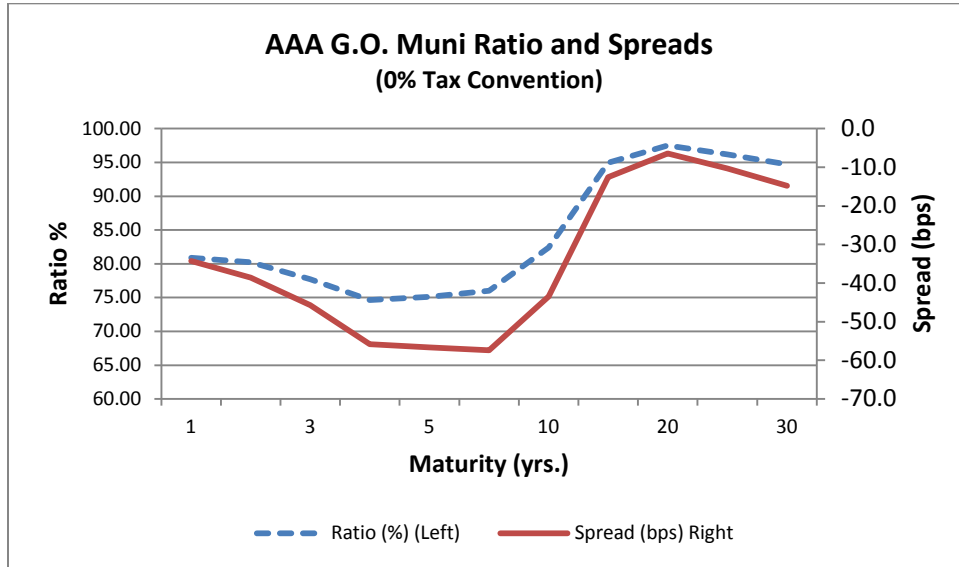


Relative Value by Maturity

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

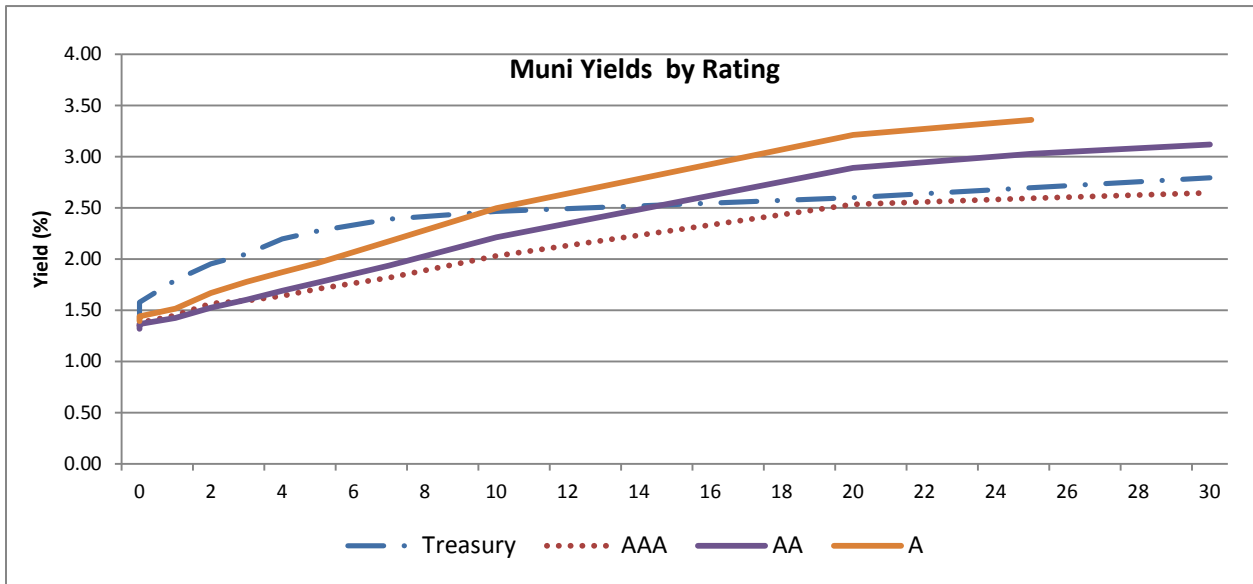
1/8/2018 Maturity (yrs.)	Yield-to-worst (%)		0% Tax Rate		35% Tax Equivalent	
	AAA Gen. Oblig.	Treasury	Spread (bps)	Ratio (%)	Spread (bps)	Ratio (%)
1	1.45	1.79	-34.3	80.9	43.8	124.4
2	1.57	1.95	-38.6	80.2	45.7	123.4
3	1.59	2.05	-45.7	77.7	40.1	119.5
4	1.64	2.20	-55.8	74.6	32.5	114.8
5	1.71	2.28	-56.6	75.1	35.4	115.6
7	1.82	2.39	-57.4	76.0	40.5	116.9
10	2.03	2.47	-43.4	82.4	65.9	126.7
15	2.36	2.49	-12.5	95.0	114.5	146.1
20	2.54	2.60	-6.5	97.5	130.0	150.0
25	2.59	2.70	-10.4	96.2	129.3	147.9
30	2.65	2.80	-14.8	94.7	127.8	145.7

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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