

Muni Fortnightly

Treasury yields moved lower on unimpressive economic data and slowing of risk appetite. Muni yields follow. Puerto Rico COFINA restructuring agreement receives court approval and bond exchanges expected to proceed within the next few weeks.

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Bottom Line:

- Treasury yields fell as risky-asset appetite plateaued and economic data were unimpressive.
- Muni yields fell alongside Treasuries.
- Muni funds saw net inflows adding to the year's gains for funds.
- Detroit upgraded to BB- by S&P.
- COFINA restructuring receives court approval and exchanges will proceed within a few weeks.
- S&P Puerto Rico Total Return Index was +2.1% last week (+2.27% YTD).

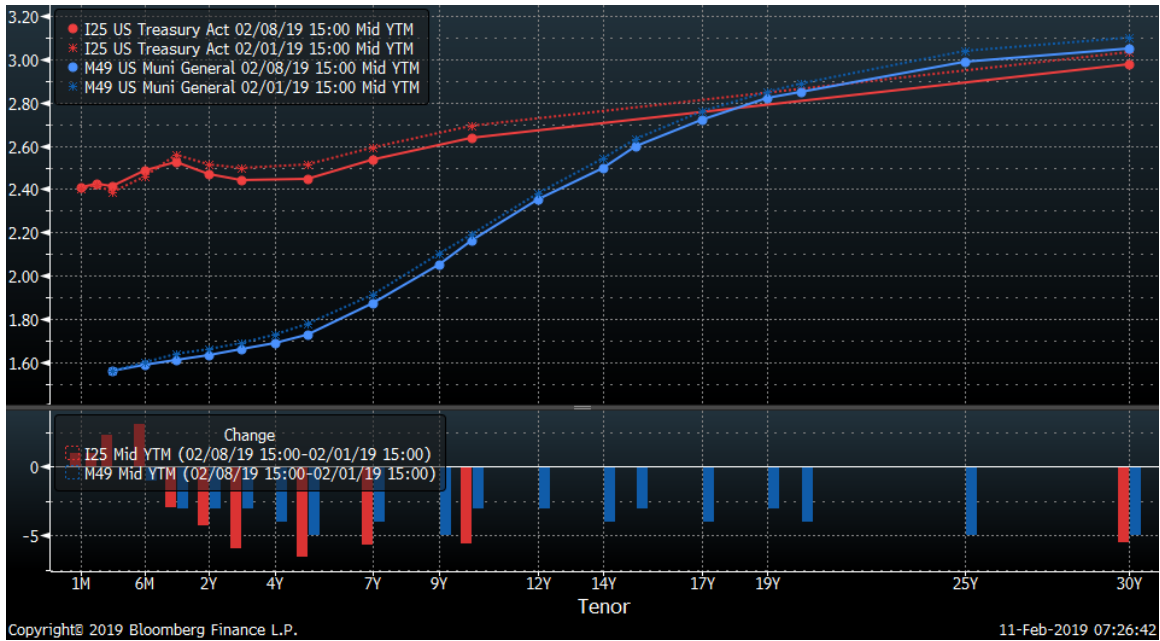
What Happened in the Bond Markets Last Week?

- Treasuries, amidst some stagnation in the ravenous appetite for equities, experienced a slow and steady descent over the course of the entire week. There was no obvious follow-through on the previous week's outsized gains in the labor report. What there was in higher profile economic data (factory orders, ISM Non-Mfg.), it was un-impressive. Even less impressive has been the continuing below-expectations (which are already low) economic data from Eurozone. Fed Rate cuts (not hikes) are the predominant implied next action priced into futures.
- Municipal bonds' yields were similarly impacted as they also fell.

Yields (Figure 1):

- For the week ending 2/8/19, Treasury yields were lower; 2-year Treasury Note yields were -4.3 bps to 2.47%, 5-year Notes yields were -6.6 bps at 2.45%, 10-year Notes yields were -5.5 bps to 2.64% and 30-year bonds yields were -5.5 bps at 2.98%.
- Bloomberg Municipal Index curve yields were lower; AAA-rated GO yields; 2-year bonds were -3 bps at 1.63%, 5-year bond yields were -5 bps at 1.73%, 10-year bond yields were -3 bps at 2.16% and 30-year bonds were -5 bps at 3.05%.
- The Ratio of 10-year AA GO debt to 10-year Treasury yields moved slightly higher from the previous week to 82.1 last week. The year-to-date average is 83.0 and the 12-month average is 85.5. Ratios across the curve rose slightly.

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 - 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.

Figure 2a - Muni Ratio – Data Source: Bloomberg

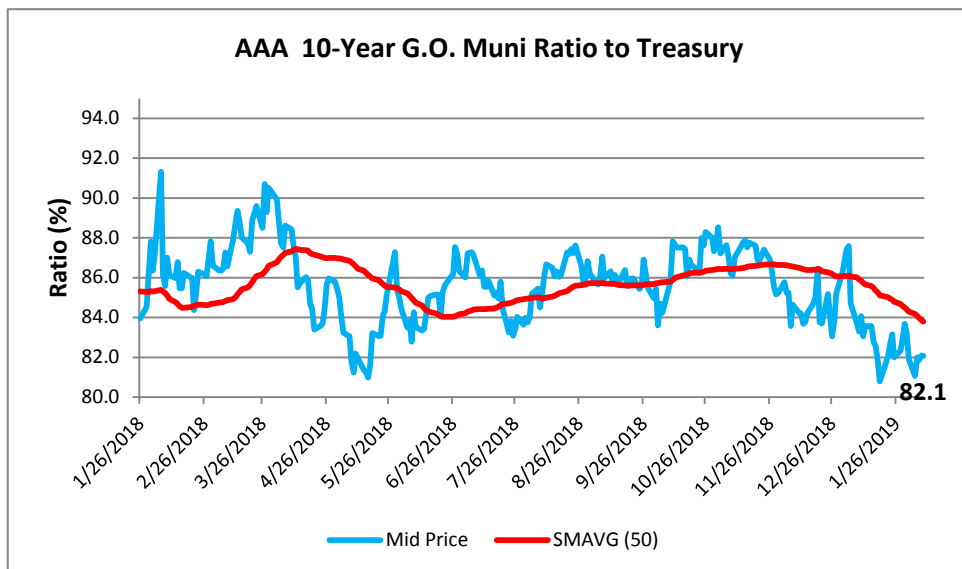
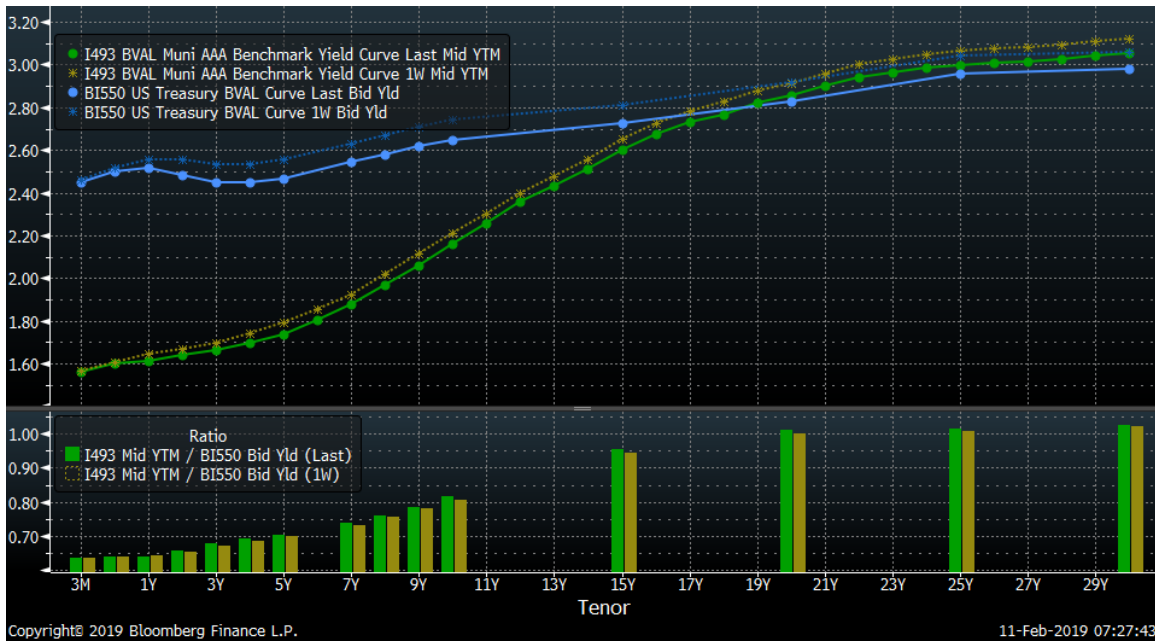
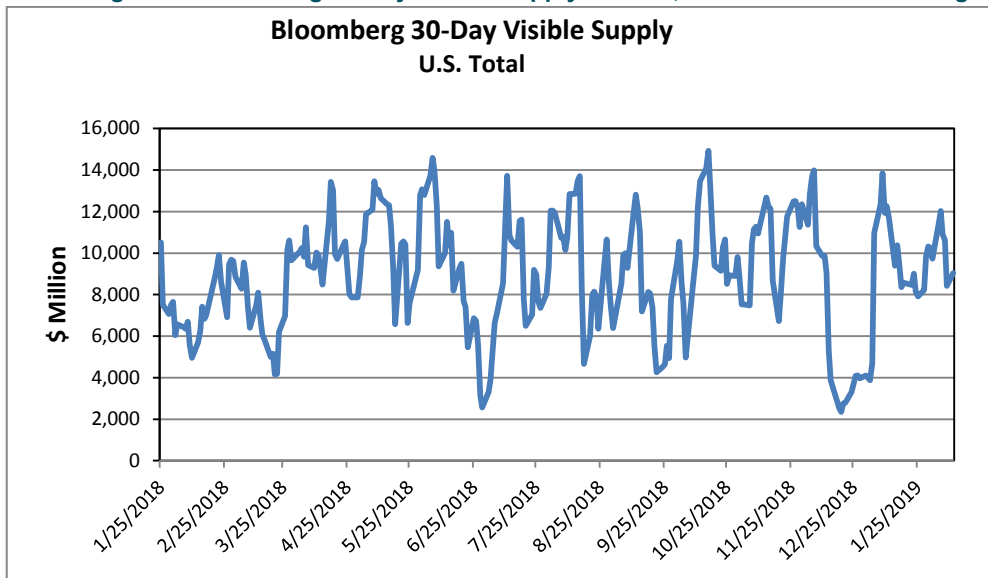


Figure 2b - Muni Ratios Across the Curve: 1-month Change – Data Source: Bloomberg



Supply (Figure 3) – Bloomberg 30-Day Visible Supply currently stands at \$9.0 billion down from \$11.4 billion this time last week. The YTD average visible supply is \$9.7 billion and the 12-mo average is \$9.1 billion.

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

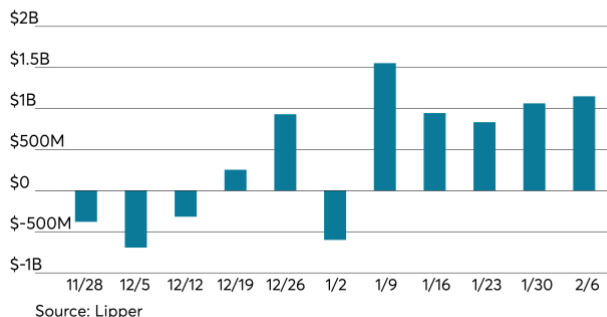


Articles of Interest

Municipal Fund Flows: According to Lipper data, municipal bond funds had \$1.1 billion of net inflows after \$1.1 billion of net inflows during the previous week. The four-week moving average is net inflows of \$1.1 billion. ETFs had net outflows and high-yield funds had net inflows.

Continuing confidence

Lipper: Municipal bond funds saw inflows in latest week



Detroit S&P Credit Rating Upgraded to BB-: S&P upgraded the Detroit, MI bond rating one notch to BB- as government finances improve and as S&P said that the upgrade reflects the city’s ability to cover pension and debt costs without incurring budget shortfalls. Last April Detroit emerged from state oversight after three years without budget deficits on the back of higher tax revenues and ability to display its ability to access capital markets.

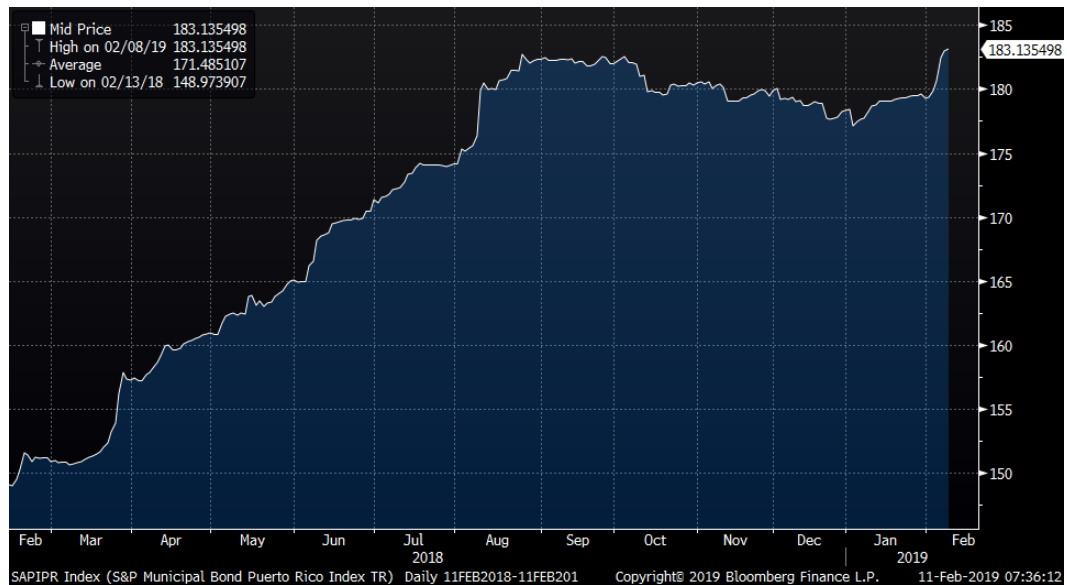
Tobacco Bonds Underperform (Bloomberg Brief): Tobacco bonds suffered the worst January since the 1998 Master Settlement Agreement which spawned the asset category. Tobacco bonds have lost 3.6% since the end of September. Altria, increased its estimate for the decline in tobacco sales from 3-4% to 3.5-5 %. These bonds occupy about 20% of the Bloomberg Barclay’s Municipal Bond Index.

Illinois Credit Issues Facing the New Governor (Moody’s): Moody’s commented that several credit-related issues face the State of Illinois’ new governor (JB Pritzker). The biggest issues are 1) maintaining pension contribution legal requirements (which are still insufficient to keep unfunded liabilities to rise), 2) continuing budget deficit, that without tax hikes, will add to the current debt load/service cost, 3) economically, the state has seen declining population despite being one of the largest and most diverse economic bases.

Puerto Rico:

- **COFINA:** The restructuring deal approved by bondholders in January was approved by the U.S. District Court, clearing the way for an agreement to be executed. COFINA will exchange its \$17.6 billion of existing securities for \$12 billion of new bonds. Subordinate bondholders will receive 56.4 cents on the dollar and senior bondholders will receive 93 cents. It is reported that the exchange could begin as early as within the next few weeks. Attention will then begin to shift to the restructuring process for the approximately \$13 billion of general obligation bonds.
- **The S&P Municipal Bond Puerto Rico Index** finished at 183.1 on Friday vs. 179.4 at the end of the previous week, +2.1% (+2.7% YTD)

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

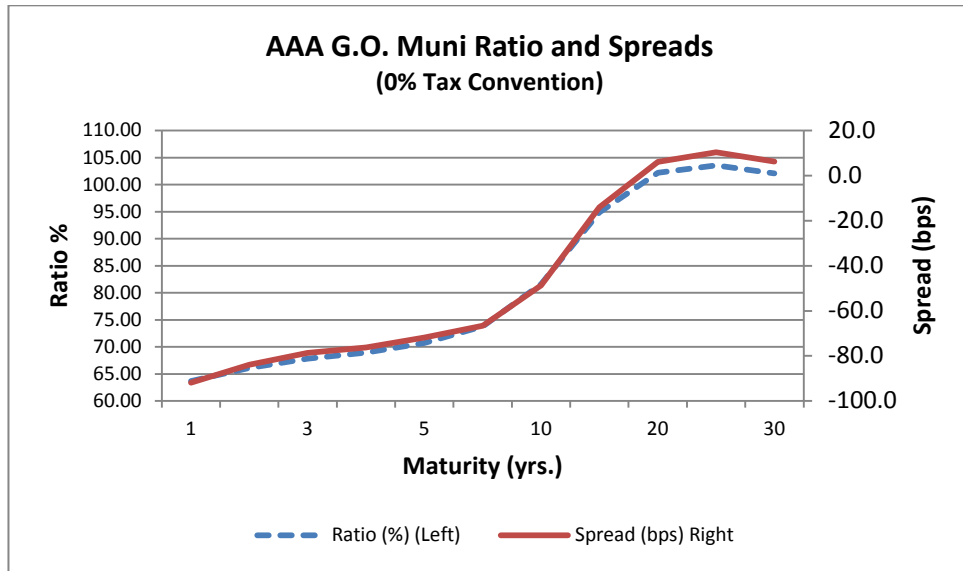


Relative Value by Maturity

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

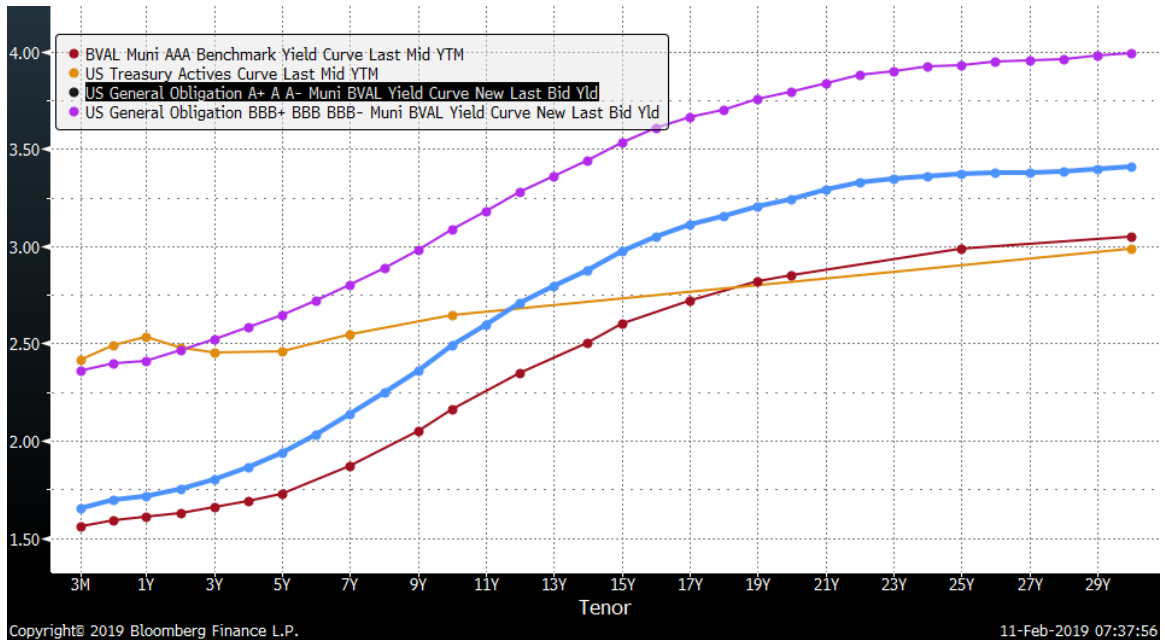
2/11/2019	Yield-to-worst (%)		0% Tax Rate		35% Tax Equivalent	
Maturity (yrs.)	AAA Gen. Oblig.	Treasury	Spread (bps)	Ratio (%)	Spread (bps)	Ratio (%)
1	1.61	2.53	-91.9	63.7	-5.1	98.0
2	1.64	2.48	-83.9	66.1	4.2	101.7
3	1.66	2.45	-78.7	67.8	10.7	104.4
4	1.69	2.46	-76.3	68.9	14.9	106.1
5	1.74	2.46	-71.9	70.7	21.6	108.8
7	1.88	2.54	-66.7	73.8	34.4	113.5
10	2.16	2.65	-48.7	81.6	67.6	125.5
15	2.60	2.74	-14.0	94.9	126.1	146.0
20	2.86	2.79	6.2	102.2	160.0	157.2
25	3.00	2.89	10.4	103.6	171.6	159.4
30	3.05	2.99	6.3	102.1	170.6	157.1

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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