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Munis weaken on backs of UST, but still outperform

By

Christine Albano, Aaron Weitzman

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Munis were a touch weaker Tuesday after U.S. Treasuries sold off over night with the 10-year hitting 1.73%, a high for the year and more than three times its lows of 0.50% in August 2020. Primary offerings were easily absorbed with Pennsylvania turnpikes repricing to lower yields and munis continued to outperform its taxable counterpart.

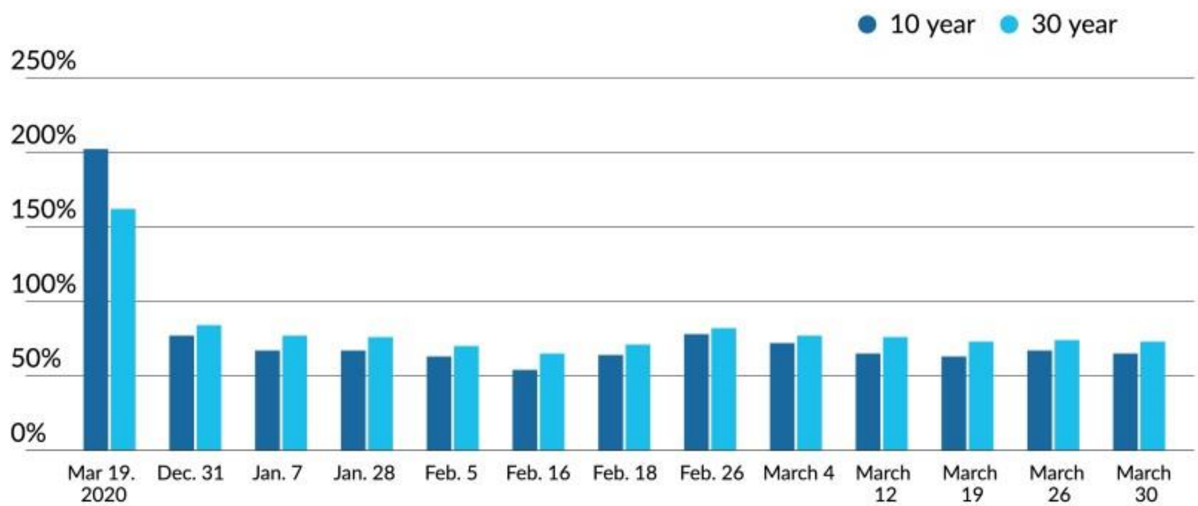
Larger fund flows, lower supply and optimism surrounding issuer credit post-stimulus allowed for a March price reversal that avoids posting two consecutive months with losses.

"The curve has benefited from a trail off in supply as month-end draws to a close, where heavier issuance would otherwise have kept a closer watch on yields," said Kim Olsan, senior vice president at FHN Financial.

Next to UST, the comparable AAA rate has only doubled from its August lows.

"Much like a year ago when the forces behind the UST rally caused a municipal disconnect, the current theme is a separate story," Olsan said.

Muni to UST ratios



Source: Refinitiv MMD

Municipal to UST ratios hovered around the low 60% and 70% in 10-and 30-years. The ratio sat at 65% in 10 years and 73% in 30 on Tuesday, according to Refinitiv MMD, while ICE Data Services showed ratios at 64% in 10 years and 74% in 30.

"For munis, the outlook for sustained tax-sheltering combined with improving credit quality among major sectors has lent a resiliency to the curve," Olsan said. "As long as the 10-year spot can hold above 1% and mainstream AA names can be offered there or higher, relative value can take more of a backseat."

A slow-grinding bid is expected to emerge this week as advisors prepare for quarter-end reporting, according to Michael Pietronico, chief executive officer at Miller Tabak Asset Management.

“Given the short holiday-related week, we expect low volatility to be the norm,” Pietronico said. “Our expectation is that upward pressure on market interest rates will resume next month as the economic data is likely to show continued economic growth and upward pressure on consumer prices.”

Tuesday’s slate kicked off with a handful of relatively sizable offerings.

Jefferies LLC priced $437.2 million of taxable enhanced tobacco settlement asset-backed bonds for the Golden State Tobacco Securitization Corp. (Aa3/A+/AA-/). Bonds priced at par in 6/1/2038 to yield 3.115%.

PNC Capital Markets LLC repriced $250 million of turnpike revenue bonds for the Pennsylvania Turnpike Commission (A1/A+/A+/AA-) with bumps to scales from 10 basis points on the short end to three out longer. Bonds in 2022 with a 3% coupon yield 0.11% (-10), 4s of 2026 0.69% (-8), 5s of 2031 at 1.45% (-7), 4s of 2036 at 1.90% (-3), 4s of 2041 at 2.12% (+7), 5s of 2047 at 2.14% and 4s of 2051 at 2.36%.

In the competitive market, Palm Springs USD, California sold $118 million of general obligation bonds (Aa3) on Tuesday.
Bonds ranged from 2022 with a 2% coupon to yield 0.10% to 2034 with a 1.75% coupon at par. The bonds between 2030 and 2034 were insured by AGM.

Oklahoma City, Oklahoma (Aaa/AAA//) sold $116.6 million of general obligation bonds to JP Morgan Securities LLC. Bonds in 2023-2025, 2031, 2036, 2038 and 2040 were all away presale. Bonds in 2023 with a 2% coupon yield 0.16%, 2s of 2026 at 0.59%, 3s of 2031 at 1.30%, 3s of 2036 at 1.67%, 3s of 2041 at 1.88%, callable in 3/1/2029.

Secondary market
Trading showed some weaker prints outside of five years, following UST's lead. The short end was again steady.

Washington GOs, 5s of 2022, traded at 0.09%. Loudon County, Virginia 5s of 2022, at 0.11%-0.12%.

California 5s of 2026 at 0.62%. NYC TFA 5s of 2027 at 0.90%. Delaware GOs, 5s of 2027, at 0.78%. California 5s of 2028 at 0.94%.

North Carolina GOs, 5s of 2031, traded at 1.25%.

New York City TFA 4s of 2046 at 2.30%. Ohio waters, 5s of 2050 at 1.77%-1.73%. Triborough Bridge and Tunnel Authority 5s of 2051 at 2.17%.

High-grade municipals were steady on bonds inside five years, but were cut two on bonds five years and out the curve on Refinitiv MMD's scale. Short yields were at 0.09% in 2022 and 0.12% in 2023. The 10-year rose one basis point to 1.11% and the 30-year rose one to 1.76%.

The ICE AAA municipal yield curve showed short maturities also steady at 0.10% in 2022 and 0.15% in 2023. The 10-year rose one basis point to 1.09% and the 30-year yield rose two basis points to 1.75%.

The IHS Markit municipal analytics AAA curve showed yields at 0.09% in 2022 and 0.14% in 2023, the 10-year at 1.07%, two higher, and the 30-year at 1.72%, two higher.

The Bloomberg BVAL AAA curve showed yields at 0.08% in 2022 and 0.12% in 2023, while the 10-year rose one basis point to 1.06%, and the 30-year yield one higher at 1.75%.

The 10-year Treasury was at 1.73% and the 30-year Treasury was yielding 2.40% near the close, while the Dow lost 74 points, the S&P 500 fell 0.19% and the Nasdaq gained 0.05%.

Consumer confidence continues to grow, as does inflation

The consumer confidence index jumped to its highest reading in a year in March and came in much higher than expected, as positive readings of the economy on the heels of vaccine news and stimulus checks arriving in pockets.

The index rose to 109.7 from 90.4 a month earlier, the Conference Board reported. Economists polled by IFR Markets expected a 97.0 read.

“A better reading should have been anticipated for the month of March, as it should have been reflective of households getting $1,400 checks,” according to Kevin Flanagan, head of fixed income strategy at WisdomTree. “With that being said, I wasn’t surprised by the increase, but I was with the magnitude.”

The present situation index gained to 110.0 from 89.6 and the expectations index grew to 109.6 from 90.9.

“Consumer confidence increased to its highest level since the onset of the pandemic in March 2020,” said Lynn Franco, senior director of economic indicators at The Conference Board.

“Consumers’ assessment of current conditions and their short-term outlook improved significantly, an indication that economic growth is likely to strengthen further in the coming months. Consumers’ renewed optimism boosted their purchasing intentions for homes, autos and several big-ticket items," she said. "However, concerns of inflation in the short-term rose, most likely due to rising prices at the pump, and may temper spending intentions in the months ahead.”

The number of respondents who see business conditions as good rose, while those who see them as bad fell. The number who say jobs are plentiful inched up while those thinking jobs are hard to get slipped, for the second consecutive month.

“The improvement across the board is a reflection that underlying sentiment in the consumer sector shows where we are in the recovery story,” Flanagan said. “The vaccine in the common denominator, as we continue to progress with the distribution. Just this morning, there are reports of surging COVID-19 cases that would have weighed on sentiment before but not now.”

According to Rhea Thomas, senior economist, Wilmington Trust, U.S. consumer confidence and inflation expectations “continue to edge higher on the back of vaccine progress and stimulus distributions.”

“For the first time in a year, more consumers expected a rosier rather than poorer economic outlook in the year ahead, particularly with regard to the labor market,” she said.

Meanwhile, a Federal Reserve Bank of Dallas survey showed the service sector in March increased at its fastest pace since mid-2019,” according to the monthly Texas Manufacturing Outlook Survey conducted by the Federal Reserve Bank of Dallas, released on Tuesday.

The general business activity index rose to 28.9 in March from 5.0 in February, while the company outlook index grew to 26.1 from 2.7.

The six-months ahead future outlook index for business activity swelled to 42.4 from 27.7 and the future company outlook index gained to 40.6 from 26.9.

The outlook uncertainty index dropped to negative 10.0 from positive 1.7.

Input prices index rose to 26.5 from 24.4, while selling prices increased to 12.1 from 9.4. Wages and benefits climbed to 19.9 from 12.5, the employment index rose to 13.1 from 2.7, while the hours worked index grew to 8.3 from 3.3.

The six-month ahead in the future for input prices gained to 42.7 from 36.2, while selling prices climbed to 31.1 from 23.8. Wages and benefits soared to 43.8 from 33.5, while the employment index surged to 35.2 from 28.8, and the hours worked index jumped to 14.3 from 6.7.

There has been some pressure on prices, which is an indicator of inflation.

Thomas noted that inflation expectations for the next five to 10 years have also nudged higher to 2.8% in the latest reading, the highest since July 2015.

“While we do not currently expect inflation to run out of control forcing the Fed to tighten policy in the near term, it remains a risk we continue to monitor closely,” she said.

Flanagan added that “visible” inflation has increased this year and is up almost a full percentage point since November.

“We have a fascinating dynamic, as the Treasury market is increasing its inflation expectations and now consumers are showing that as well but then you have the Fed, and they believe higher inflation is temporary,” he said. “Stimulus shows no signs of being reserved and that should result in price pressures and higher inflation.”

He did also say that it will be something to watch over the next few months, but the overarching trend for higher inflation is being put into place.

“All in all, the Fed would rather have a conversation about inflation, rather than deflation.”

Also released Tuesday, the S&P CoreLogic Case-Shiller index showed home prices rose 11.2% in January on an annual basis, up from the 10.4% increase in the prior month’s read. The 10-city composite grew 10.9% after 9.9% the month before, while the 20-city composite jumped 11.1% year-over-year after 10.2% growth reported a month earlier.

Economists just missed the mark, as they anticipated a gain of 11.1% annual growth.

Lynne Funk contributed to this report.

Christine Albano

- **Mailto**

Aaron Weitzman

Markets Reporter , The Bond Buyer

- **Twitter**