THE BOND BUYER

# Taxable munis take center stage

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A few taxable deals came into a weaker market today, highlighting the significance of what issuers can tap into by issuing taxable munis as opposed to the traditional tax-exempt bond.

Two Goldman-led taxable deals were priced today.

Goldman Sachs priced Tuscaloosa County Industrial Development Authority's (NR/NR/NR) $612 million of gulf opportunity zone refunding taxable bonds for Hunt Refining Project.

Goldman also priced Anaheim Public Finance Authority's (A1/A/AA-) $175 million of senior lease revenue refunding and taxable bonds.

Eric Kazatsky, portfolio manager at Clark Capital Management, said that that over the past 24 months, municipal bonds have been some of the best performing subsectors of the fixed income market. High-yield municipal bonds have led fixed income returns, followed closely by both taxable and tax-exempt munis. Relative to the tax-exempt market, the taxable muni market has far fewer issuers and tends to sell bonds in larger issuance tranches.

"This enhances the market's attractiveness to both retail and institutional buyers because it is more liquid and less fractured," he said. "The taxable muni market has also benefited from global attention from foreign investors seeking out holdings in a lower-default market, while capturing higher yields than global sovereigns offer."

He continued to say that as the U.S. economy heads into the later stages of the economic cycle, taxable municipal bonds also serve as an alternative investment that is uncorrelated to the risks in the corporate bond markets. Taxable municipal bonds are immune to corporate behaviors, such as mergers and share buybacks, which can adversely impact corporate credit, he added.

"Traditionally, we have viewed the role of taxable municipal bonds as an alternative to corporate bonds within taxable portfolios," Kazatsky said. "However, we believe that taxable munis can also benefit tax-exempt investors, especially in coastal states such as California and

New York. This is due in part to: The precipitous decline in tax-exempt muni rates and the fact that taxable munis carry an exemption from state income taxes."

"If the end of 2018 and start to 2019 have been a euphoric summer for bonds, then winter is most likely due to come to the fixed income markets," Kazatsky said. "Bonds should heed the sentiment that even if things are good now, we must always remain vigilant for a darker period. Imagining a catalyst that could prolong the bond rally is difficult given the level of absolute rates in the corporate and, especially, tax-free markets. Yet, several headwinds remain."

He added that there is no denying that the bond market moved fast and furious during February and March.

"Following the laws of physics, what goes up must come down, right? Even though there seems to be some support to even higher bond prices as the market is implying odds of a cut in the fed funds rate later this year, we remain skeptical of such a move higher from already lofty valuations."

**Technical difficulties**

The long-term impact of historically low yields and ratios, as well as the overall supply scarcity is even more pronounced on holiday-shortened weeks like this one, according to Fred Yosca, managing director of underwriting and trading at BNY Mellon Capital Markets LLC.

"There's not a lot going on, and the market feels a little softer," he said on Wednesday morning, a day before the market takes a hiatus for the Good Friday holiday. "Ratios continue to be horrendous on any kind of historical basis," he said, noting that the current municipal to Treasury ratio on high-grade paper is 90% on 30-year paper — a level not seen since Jan. 2, 2018 when the 30-year ratio was 90.6%.

The current 10-year ratio has declined to 75%, which Yosca called "pretty dismal." The 30-year ratio was as high as 100.7% and the 10-year was as high as 85.1% back on Dec. 31, according to MMD data. The low ratios and yields are impacting trading.

"It's hard to justify having a bid side here," he added, noting that the light new-issue calendar consisting of many high-grade, smaller-sized deals this week isn't helping satisfy all the demand. Scarcity is being made worse by the removal of advanced refunding product in the market, which fuels a "permanent reduction in supply," Yosca said.

Given the current market technicals, municipals are "hanging in there" — with MMD only cutting the generic triple-A municipal scale by one basis point between 2020 and 2027 and two basis points from 2028 and beyond, Yosca noted."That's hardly a rout," he said.

Meanwhile, he said fund flows remain positive, the calendar remains very light, and "there's no indication that either one of those is going to change anytime soon.

“A ground swell of issuers taking advantage of low borrowing costs could present a material improvement and chief catalyst for a change in the current scenario", Yosca said.

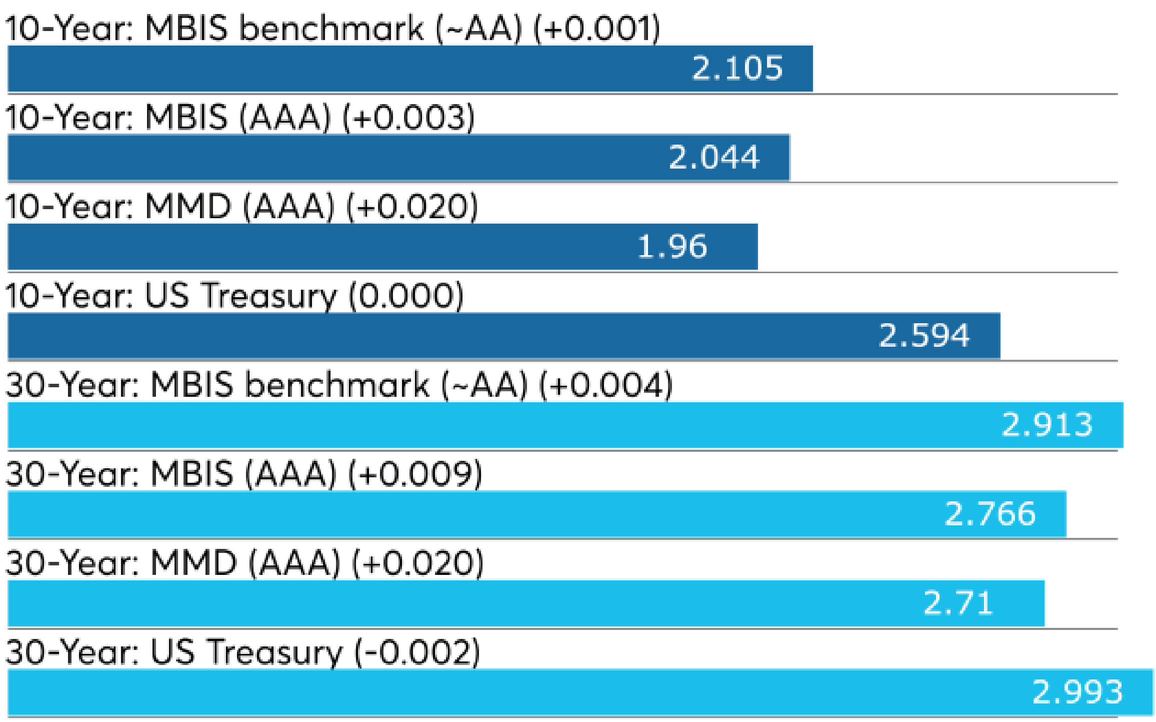
In the meantime, traders face a challenging market, he added, especially since “no one has a bearish forecast of rates soaring in Treasuries,” he added.

“You have to hold your nose and jump to make a bid in these kinds of ratios,” he said of the combination of low yields, high prices and declining ratios. The future impact of continued scarcity, rising prices, and lower ratios will help municipals maintain a strong tone, but the market is longing for a material change, he said.

“If there’s a shortage of anything the price stays high,” he said.

**Secondary market**

Munis were weaker on the MBIS benchmark scale Wednesday, which showed yields less than one basis point higher on both the 10-year maturity and the 30-year maturity. High-grade munis were also weaker, with yields increased by less than one basis point in both the 10-year and 30-year.



MBIS indices are updated hourly on the Bond Buyer Data Workstation

On Refinitiv Municipal Market Data’s AAA benchmark scale, the yields on both the 10-year muni GO and the 30-year muni increased by two basis points.

The 10-year muni-to-Treasury ratio was calculated at 75.6% while the 30-year muni-to-Treasury ratio stood at 90.6%, according to MMD.

**Previous session's activity**

The MSRB reported 41,151 trades Tuesday on volume of $12.686 billion.

California, Texas and New York were most traded, with the Golden State taking 19.807% of the market, the Lone Star State taking 12.078% and the Empire State taking 11.991%.

The San Francisco Airport Commission 4.25s of 2032 traded 65 times with a par of $43 million.

Data appearing in this article from Municipal Bond Information Services, including the MBIS municipal bond index, is available on The Bond Buyer Data Workstation. Click here for a brief tour of the Workstation, or contact Ziad Saba at 212-803-6079 for more information.