THE BOND BUYER

Munis see 'remarkable' turnaround, but caution is warranted

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Municipals made further gains on Friday, pushing yields down as much as another eight basis points, to close out a seven-day rally, the likes of which haven't been seen since the end of March 2020 as the market began to rebound from the COVID-19-led turmoil.

Triple-A yields have fallen more than half a percentage point on the 10- and 30-year, as the asset class has outperformed U.S. Treasuries, moving ratios back down below 100% on the 10- and 30-year.

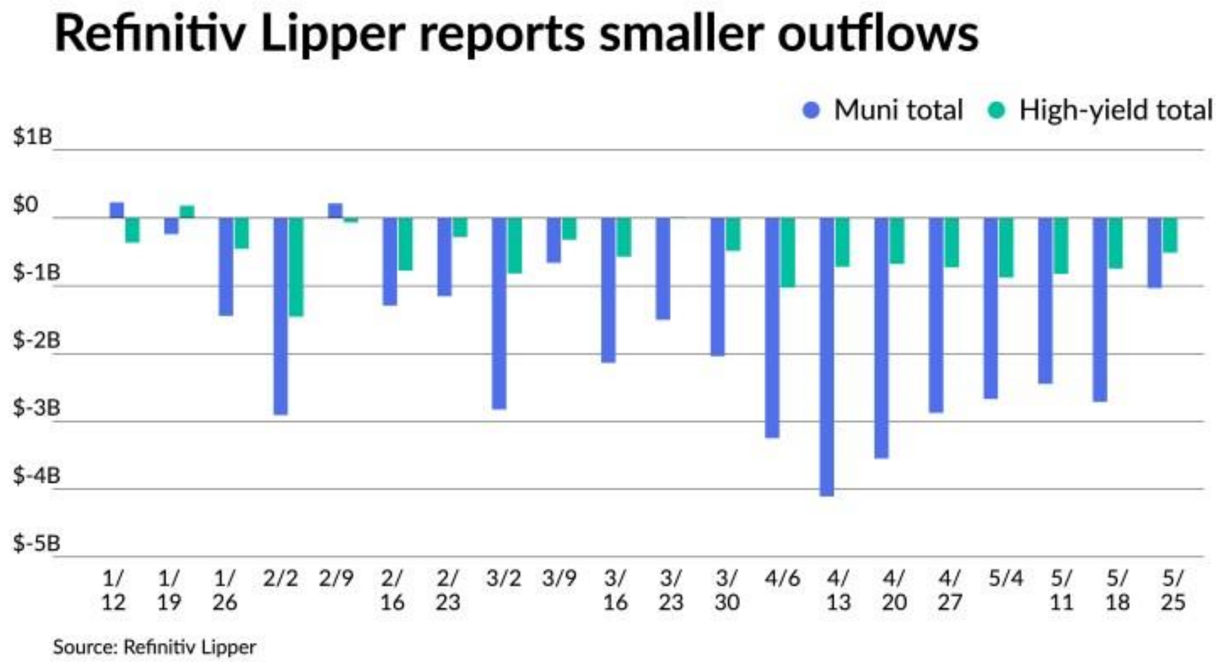
Muni-to-UST ratios fell to 77% in five years, 91% in 10 years and 95% in 30, according to Refinitiv MMD's 1 p.m. read. ICE Data Services had the five at 77%, the 10 at 91% and the 30 at 97% at a 2 p.m. read.

"Although it is too early to call it a win, this week's price action brings us some hope that the end of this year's crisis might be in sight," said Barclays strategists Mikhail Foux, Clare Pickering and Mayur Patel in a weekly report. "One could say that it was the first real broad-based municipal rally this year; and with yields dropping 40 basis points-plus across the curve, in many ways it has been truly remarkable."

However, there are still a lot of uncertainties on the economic front, rate volatility might spike again, and supply might surprise to the upside, they said.

"On the back of a very strong market performance, we saw a lot more demand for munis from investors in both primary and secondary markets; and while some investors used this week's strong market performance to sell into strength, in general, selling has meaningfully subsided," according to the report.

Bids wanteds figures fell this week, though still surpassed the $1 billion mark every day. Mutual fund outflows fell to $1.035 billion for the week ending May 25, per Refinitiv Lipper data released Thursday.



This is the smallest outflow since March 9. Outflows in 2022 total $37.6 billion, marking the 15th consecutive week. The last time there was on an outflow streak of this magnitude was in 2013 during the Taper Tantrum when fund outflows lasted 33 weeks and totaled $42.3 billion. Participants expect outflows to slow, but are still cautious about the timing of a return to inflows.

"We do not foresee muni fund outflows completely stopping in the near term (although we could see one to two weeks of a temporary relief), but summer redemptions should help support the market," Barclays said.

This is especially true "if supply does not overwhelm, which remains a big question mark, as many issuers might become much more aggressive in tapping the primary market if conditions improve," the strategists said.

Thirty-day visible supply sits at $14.98 billion, per Bond Buyer data, while net negative supply is $18.928 billion, per Bloomberg data.

Muni losses "have ensnared all buyer classes and it would take a miracle to retrace the negative year to date returns with performance on track (for now) to book record deficits," Oppenheimer's Jeff Lipton said.

Jeff Lipton, managing director of municipal credit at Oppenheimer & Co., also pointed out that despite the much improved tone, fund flows continued negative for the 15th consecutive week yet the pace of outflows appears to be ebbing.

"Secondary market bid list activity slowed toward the end of the week, yet we are hesitant to identify a renewed trend given the extended Memorial Day weekend with attendant lighter staffing levels on the desks," Lipton said in a weekly report.

Market technicals are expected to generate heavy reinvestment needs over the summer months, Lipton noted. According to Bloomberg, about $28 billion of bond calls and maturing securities are scheduled over the next 30 days, up about 4.3% from the prior week, he said.

"Even holding the looming reinvestment needs off to the side, heavy cash has been available for investment guidance and we see deployment of a portion of this money into the municipal asset class should our technical outlook take hold against a more opportunistic investment backdrop," Lipton said. "Improved technicals, taken together with what could be a more stabilized rate environment, should catalyze admirable muni performance and may begin to spark a reversal in fund flows."

A lot will depend on rates of course, and Barclays strategists said they still see quite a bit of risk as the market is close to the low end of the recently established trading range.

"Moreover, with yields much higher this year, most low coupon bonds are trading well below par, and durations of investor portfolios have meaningfully extended," they said. The same goes for the durations of the muni investment grade and high-yield indexes, "making investors more susceptible to rate volatility — hence more defensive."

Notably, this duration increase of the IG muni index is still smaller than the one in 2013, and the largest portion of this increase has taken place in the past 1.5 months despite the yield of the index increasing much more in the first three months of the year, according to Barclays.

"As durations of investor portfolios have increased, we have started to see much less appetite for longer-term debt, and yield curves have started steepening," Barclays said. "If investors start feeling more confident that rates are stabilizing, we could see more demand for long bonds; in our view, the 20-year part of the curve might present the best value for investors looking to extend, as the 10s20s differential is close to its highest point in a decade."

Lipton noted that while the ultra-short tenors of the muni market have been the best performers year-to-date, the five- to 10-year part of the curve has captured the May outperformance as longer maturities have been less responsive to UST price activity.

"As we chart the course for the remainder of the year, investors are advised to limit maturity extension, as 90% of the curve can be captured within 10 years and about 75% can be realized with a five-year investment," Lipton wrote.

Lipton expects shorter tenors to continue to outperform. Lipton recommends that investors preserve credit quality given what they see as a visible runway for credit spreads to widen.

Muni losses "have ensnared all buyer classes and it would take a miracle to retrace the negative year to date returns with performance on track (for now) to book record deficits," Lipton said.

Per Bloomberg, the Municipal Index is now positive at 0.91% (down 7.99% YTD), high-yield up 0.25% (negative 9.63% YTD), taxables +0.01% (down 13.19% YTD) and the impact index is +1.01% (down 10.36% YTD).

"Although munis are outperforming U.S. Treasuries month to date, at 0.78%, they are lagging on an annual basis at negative 7.78%," Lipton said.

Should muni yields and ratios return to higher ground, "buying opportunities become more compelling for a broader investor base as crossover and foreign interest advances," he added.

Secondary trading
Massachusetts 5s of 2023 at 1.51%. Alexandria, Virginia, 5s of 2023 at 1.55%. Wisconsin COPs 4s of 2023 at 1.64%-1.62%.

Loudoun County, Virginia, 5s of 2028 at 2.20% versus 2.53% original. Howard County, Maryland, 5s of 2030 at 2.34%.

Loudoun County 5s of 2034 at 2.54%-2.53% versus 2.88% original, and 5s of 2035 at 2.56%-2.55% versus 2.93% original.

Boston 5s of 2035 at 2.57%-2.54% versus 2.66% Thursday.

Ohio 5s of 2036 at 2.62% versus 2.90%-2.79% Thursday and 3.09% original. Washington 5s of 2039 at 2.87% versus 3.26% Tuesday and 3.33% Monday.

Triborough Bridge and Tunnel 5s of 2047 at 3.30% versus 3.49%-3.40% Thursday, 3.57%-3.44% Wednesday and 3.94%-3.84% Monday.

New York City TFA 5s of 2047 at 3.29%-3.28% versus 3.35% Thursday, and 4.00% Friday.

Illinois Finance Authority green 5s of 2051 at 3.57% versus 3.87%-3.86% Wednesday.

Los Angeles DWP 5s of 2052 at 3.07% versus 3.16% Thursday, 3.33% Wednesday and 3.80% Friday.

Massachusetts Bay Transportation Authority 5s of 2052 at 3.01%-3.00% versus 3.21% Wednesday and 3.48% Monday.

AAA scales

Refinitiv MMD’s scale was bumped eight basis points at a 1 p.m. read: the one-year at 1.53% (-8) and 1.85% (-8) in two years. The five-year at 2.11% (-8), the 10-year at 2.49% (-8) and the 30-year at 2.83% (-8).

The ICE municipal yield curve saw five to six basis point bumps across the curve: 1.56% (-5) in 2023 and 1.89% (-5) in 2024. The five-year at 2.13% (-5), the 10-year was at 2.46% (-5) and the 30-year yield was at 2.88% (-6) at a 2 p.m. read.

The IHS Markit municipal curve saw eight basis point bumps: 1.53% (-8) in 2023 and 1.83% (-8) in 2024. The five-year at 2.10% (-8), the 10-year was at 2.50% (-8) and the 30-year yield was at 2.84% (-8) at 3 p.m.

Bloomberg BVAL saw six to eight basis point bumps: 1.58% (-6) in 2023 and 1.86% (-6) in 2024. The five-year at 2.18% (-6), the 10-year at 2.50% (-6) and the 30-year at 2.83% (-8) at a 2 p.m. read.

Treasuries were little changed.

The two-year UST was yielding 2.478% (flat), the three-year was at 2.635% (flat), the five-year at 2.718% (+1), the seven-year 2.764% (flat), the 10-year yielding 2.740% (-1), the 20-year at 3.157% (-1) and the 30-year Treasury was yielding 2.966 (-1) at the close.

Mutual funds see outflows

In the week ended May 25, weekly reporting tax-exempt mutual funds saw investors pull more money out with Refinitiv Lipper reporting $1.035 billion of outflows Thursday, following an outflow of $2.711 billion the previous week.

Exchange-traded muni funds reported inflows of $1.781 billion after inflows of $645.848 million in the previous week. Ex-ETFs, muni funds saw outflows of $2.816 billion after $3.358 billion of outflows in the prior week.

The four-week moving average narrowed to negative $2.215 billion from negative $2.676 from in the previous week.

Long-term muni bond funds had outflows of $654.795 million in the last week after outflows of $1.769 billion in the previous week. Intermediate-term funds had outflows of $145.451 million after $375.040 million of outflows in the prior week.

National funds had outflows of $651.618 million after $2.310 billion of outflows the previous week while high-yield muni funds reported $512.832 million of outflows after $745.392 million of outflows the week prior.

Primary to come:
The Utah Board of Higher Education (Aa1/AA+//) is set to price Thursday $505.450 million of green University of Utah general revenue bonds, Series 2022B, serials 2024-2042, term 2047. Barclays Capital.

Colorado (Aa2/AA-//) is set to price Wednesday $500 million of Rural Colorado certificates of participation, Series 2022, serials 2022-2041. UBS Financial Services.

The California Community Housing Agency is set to price Tuesday $465 million of 321 W. Ocean Development essential housing revenue bonds, consisting of $297.585 million of senior convertible capital appreciation bonds, Series A-1, terms 2062 and 2066; $52.256 million of senior capital appreciation bonds, Series A-2, term 2072; and $115.160 million of green climate-certified bonds, Series B, term 2042. Jefferies.

The Massachusetts Educational Financing Authority is set to price Thursday $394.700 million of education loan revenue bonds, Issue M, consisting of: $143.350 million of taxable senior bonds (/AA//), Series 2022A, serials 2024-2031, term 2038; $52.370 million of AMT senior bonds (/AA//), Series 2022B, serials 2024-2031, term 2038; and $28.500 million of AMT subordinate bonds (/BBB//), Series 2022C, serial 2052. RBC Capital Markets.

The New York State Housing Finance Agency (Aa2///) is set to price Thursday $394.210 million of affordable housing revenue bonds, consisting of: $68.660 million of climate bond certified/sustainability bonds, 2022 Series D-1; $209.985 million of climate bond certified/sustainability bonds, 2022 Series D-2; $24.785 million of sustainability bonds, 2022 Series E-1; and $90.780 million of sustainability bonds, 2022 Series E-2. Morgan Stanley & Co.

The Department of Water and Power of the City of Los Angeles (Aa2//AA/AA+/) is set to price Thursday $346.685 million of water system revenue bonds, 2022 Series C, serials 2023-2025 and 2034-2043, terms 2047 and 2052. Siebert Williams Shank & Co.

UMass Memorial Health Care (/BBB+/A-//) is set to price Wednesday $300 million of taxable corporate CUSIPs, 2022 Series M. Morgan Stanley & Co.

The Michigan State Housing Development Authority (Aa2/AA+//) is set to price Wednesday $199.855 million of non-AMT social single-family mortgage revenue bonds, 2022 Series A, serials 2022-2032, terms 2037, 2043 and 2053. Barclays Capital.

Competitive:
The Iowa Board of Regents is set to sell $150.320 million of University of Iowa Hospitals and Clinics hospital revenue refunding bonds, Series S.U.I. 2022C, at 11 a.m. eastern Tuesday.

Jersey City is set to sell $125.870 million of general improvement bonds at 11 a.m. Tuesday.

Beaufort County School District, South Carolina, (Aa1/AA//) is set to sell $139.610 million of general obligation bonds, Series 2022C at 11 a.m. eastern Thursday.

Jessica Lerner contributed to this report.