THE BOND BUYER

Muni rally isn't over yet, but market takes a breather

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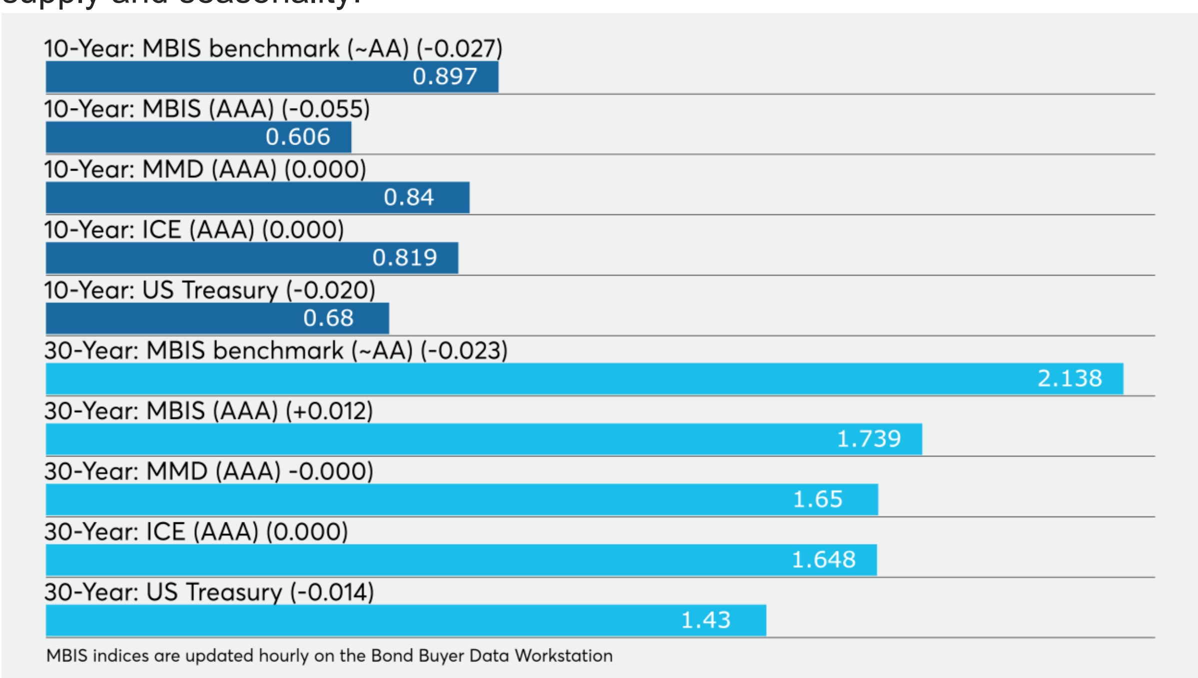
The municipal market was flat to slightly firmer Wednesday, narrowly continuing its weeks-long rally. Investors in both equities and bond markets are sidelining concerns of the longer-term effects of the virus with the hopes that a vaccine and governments reopening can act as a cushion.

“It appears as though the pace is beginning to slow somewhat,” said Greg Saulnier with Refinitiv MMD. “That said, the underlying tone is still plenty firm and it is not uncommon to see the occasional reach for high-quality bonds, particularly those AAA-rated credits that typically offer a bit of spread. While I am sure that there are some participants who would prefer to see yields back up some to improve overall secondary flows, it appears there are just too many positive factors supporting the market right now — fund inflows, a manageable supply and seasonality.”



Looking at trading on Wednesday, high-grade bonds were a focus.

Even with the news that New York City is looking to **potentially borrow $7 billion** through its Transitional Finance Authority as it faces $9 billion in lower revenues, the market didn't blink.

New York TFAs out long, 4s of 2040 traded at 2.19%. Original yield: 2.56%. Texas waters, 3s of 2040, traded at 2.01%. Original: 2.17%.

Triple-A rated Suffolk County, NY waters, 3s of 2044, yield 2.22%-2.21%. Original yield on April 28 when it priced: 3.03%.

Some are saying that higher-rated munis are attractive at these valuations.

"We don't expect widespread defaults, but issuers with already strained finances may face credit downgrades," said Cooper Howard, director of fixed-income strategy at Charles Schwab. The Fed's Municipal Liquidity Facility is yet to be operational "but is already receiving strong interest. Illinois has already said they will use it to help balance their budget which is a trend that other states could pursue."

He said the firm would be watching local finances as things start to return to normal.

"As states begin to reopen we're watching how the consumer responds to less restrictions since this will flow through to tax receipts for states and local governments," Howard said.

Short-end trades showed steadiness, but these trades show how far the muni market has come. Forsyth, NC GOs, 5s of 2022 were at 0.21%. NYC TFAs 5s of 2022 (issued in 2019) were at 0.27%. Georgia GOs 5s of 2023 traded at 0.25%-0.24%. Delaware GOs 5s of 2025 were at 0.36%-0.35%. Wake County, NC GOs 5s of 2028 at 0.65%.

Harvards, 5s of 2030, were at 0.80%-0.76%. (Original: 1.13%).

In the primary, BofA Securities priced and repriced Colorado's (Aa2/AA-/NR/NR) $500 million of certificates of participation to lower yields across the deal.

The COPs were repriced to yield from 0.26% with a 5% coupon in 2020 to 2.07% with a 4% coupon in 2039. The COPs had been tentatively priced to yield from 0.31% with a 5% coupon in 2020 to 2.20% with a 4% coupon in 2039.

Window of opportunity opening

The overall health of the municipal market is creating a potential window of opportunity as investors flush with cash are seeing record performance, strong relative outperformance and increasing supply as the market slowly recovers from the COVID-19 crisis, sources said Wednesday.

“In May, the tax-exempt market outperformed Treasuries significantly, driving the municipal and U.S. Treasury ratios massively lower, from what were, arguably, adherently distorted levels,” said Peter Delahunt, managing director at Raymond James & Associates.

He noted that municipals posted the best May price performance in history, as the benchmark scale moved in approximately 75 basis points on the front end and 60 basis points from 10 years and beyond.

For instance, in 10 years, municipals outperformed by 100 basis points, moving to 125% from 225%, while the 30-year ratio dropped to 113% from 183%, Delahunt noted.

“There have been gloomy headlines and some downgrades, but no major credit events,” he said.

Others said there is room for opportunity given the current strong technicals.

“Municipals have improved a great deal relative to Treasuries since the start of the corona crisis, but we still view them among the more attractive high-quality bond sectors,” said Anthony Valeri, director of investment management at Zions Wealth Management.

“Munis still have more room to recoup relative to Treasuries and narrow the valuation differential,” Valeri said.

As of May 27, the ratio of municipals to Treasuries was at 120.3% in 10-years and 114.7% in 30-years, according to Refinitiv MMD.

“High-grade municipals have improved steadily since the start of May,” Valeri said, noting that much of that is due to better liquidity and a return to normal functioning in the market.

“This is a welcome development and bolsters investor confidence,” he said. “The flip side for investors is that valuations are more expensive.”

That could change as potential volatility nears.

“The start of June has historically been a challenging period and political wrangling over a potential fourth round of stimulus, with a portion expected to go to assist states, could weigh on municipal valuations,” Valeri said.

“The negative headlines could pick up near-term, but if so, we’d use that as a buying opportunity,” he said.

Under that scenario, municipals could cheapen relative to Treasuries.

“I don’t expect a repeat of late March-early April, but it could provide another attractive entry point for investors,” Valeri said. “Any additional fiscal stimulus is likely to be more contentious.”

At the same time, the risk is that the average yield is now back to a historic low and provides less protection in the event that interest rates rise, Valeri noted.

“Our longer-term view is that rates stay low for a very long period of time and believe municipals could continue to benefit,” he said.

“Since high-quality muni yields are still above comparable Treasuries across the board, the after-tax yield remains quite compelling, even if low by historical standards,” Valeri said. “This should provide continued support for municipal bonds.”

Overall investor demand is healthy as heavy seasonal principle and interest redemption season begins June 1 and continues through July 1, managers said.

“Funds are experiencing inflows as the support from the Fed appears to have calmed investors,” Delahunt added, noting banks and insurance companies are active buyers as well.

“Retail demand is selectively moving out the curve away from the minuscule rates up front, and becoming more aware of the eventual need for higher taxes,” he said.

On the sell-side, issuance remains below average for the month, which is creating favorable technicals on the heels of pent-up demand.

“There’s a fair amount of cash to contribute to the demand side with limited issuance and light dealer inventories,” Delahunt said.

With a lot of supply on the day-to-day calendar, the market will be eagerly anticipating the June issuance with the pending Spring redemption season heightening demand, he said.

“The market is open, rates are low, the demand side has cash, it’s a good time to issue, and we could see a healthy increase in new-issue volume this summer,” Delahunt added.

Primary market

Aside from the Colorado deal, JPMorgan Securities priced the New York City Housing Development Corp.'s (Aa2/AA+/NR/NR) $280.715 million of sustainable development multi-family housing revenue bonds.

The $181.345 million of Series 2020 A1B bonds were priced at par to yield from 0.90% and 0.95% in a split 2024 maturity to 2.10% and 2.15% in a split 2032 maturity. Term bonds were priced at par to yield 2.20% in 2035, 2.40% in 2040, 2.65% in 2045, 2.75% in 2050, 2.85% in 2055 and 2.95% in 2060.

The $99.37 million of Series A3 bonds were priced at par as a 2060 bullet maturity to yield 1.125% with a mandatory tender in 2024.

Wells Fargo Securities priced the Pennsylvania Housing Finance Agency's (Aa2/AA+/NR/NR) $117.965 million of Series 2020-132A non-AMT single-family mortgage revenue bonds.

The issue was priced to yield from 0.30% and 0.35% at par in a split 2021 maturity to 2.15% and 2.20% at par in a split 2032 maturity. A 2035 term was priced at par to yield 2.30%, a 2041 term was priced at par to yield 2.55% and a 2051 term was priced to yield 1.50% with a 3.50% coupon.

In the competitive arena, Mercer County, N.J., (NR/SP-1+/NR/NR) sold $124.594 million of bond anticipation notes.

JPMorgan won the BANs, which were priced as 2s with a $2,151,743.28 premium, an effective rate of 0.268189%.

NW Financial Group in the financial advisor; Parker McCay is the bond counsel.

Belmont, Mass., (Aaa/AAA/NR/NR) sold $103.5 million of general obligation bonds.

JPMorgan won the bonds with a true interest cost of 2.1964%.

The issue was priced to yield from 0.14$ with a 5% coupon in 2021 to 2.36% with a 2.375% coupon in 2040; a 2043 term bond was priced at par to yield 2.40%, a 2047 terms was priced to yield 2.47% with a 2.40% coupon and a 2050 term was priced to yield 2.50% with a 2.40% coupon.

Hilltop Securities is the financial advisor; Locke Lord is the bond counsel.

Goldman Sachs, as senior underwriter, said the Memorial Sloan Kettering Cancer Center is considering the issuance of about $500 million of taxable fixed-rate corporate CUSIP bonds as early as June. Proceeds will be used for corporate purposes of the MSKCC and its affiliates.

Secondary market
Municipals ended steady on Wednesday as the market took a breather and remained at lower levels.

On Refinitiv Municipal Market Data's AAA benchmark scale, the yields on the 2021-23 maturities were unchanged at 0.11%, 0.16% and 0.23%, respectively. The yield on the 10-year GO was unchanged at 0.84% while the 30-year was steady at 1.65%.

The 10-year muni-to-Treasury ratio was calculated at 123.7% while the 30-year muni-to-Treasury ratio stood at 115.3%, according to MMD.

The ICE AAA municipal yield curve also showed maturities unchanged, with the 2021-2023 maturities at 0.13%, 0.17% and 0.23%. The 10- and 30-years was also unchanged at 0.819% and 1.648, respectively%.

ICE said the muni to Treasury ratios were little changed with the 10-year muni-to-Treasury ratio at 128% and the 30-year ratio at 113%.

"The muni market is relatively quiet in this holiday-shortened week," ICE Data Services said in a market comment. "High-yield, however, has a firmer tone and stronger bid side in several sectors including hospitals, CCRCs and corporate-backed IDRs."

IHS Markit's municipal analytics AAA curve showed the 2021 maturity at 0.11%, the 2022 maturity at 0.16% and the 2023 maturity at 0.24% while the 10-year muni was at 0.85% and the 30-year stood at 1.65%.

The BVAL curve showed the 2021 maturity fell one basis points to 0.05% and the 2022 at 0.12%. BVAL also showed the 10-year muni fall one basis point to 0.80%% while the 30-year rose one bp to 1.69%.

Munis were also stronger on the MBIS benchmark scale, with yields falling in the 10- and 30-year maturities.

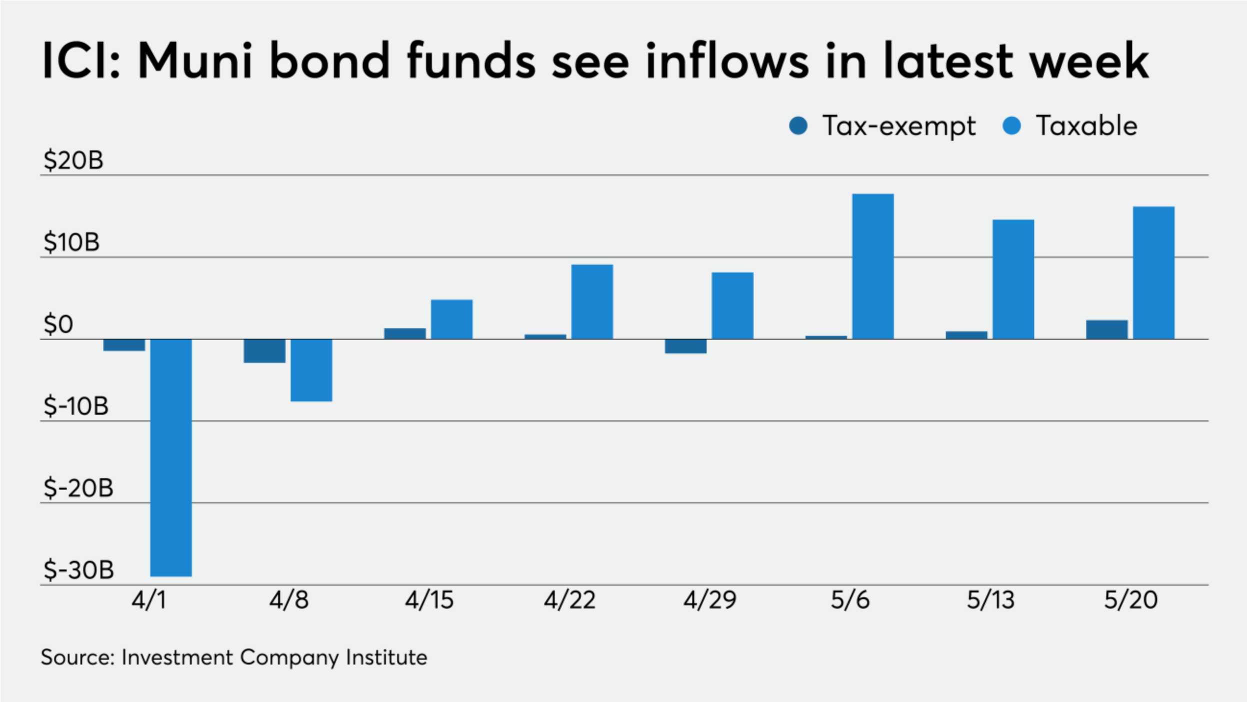
Treasuries weakened as equities rose.

The three-month Treasury was yielding 0.16%, 10-year Treasury was yielding 0.68% and the 30-year was yielding 1.43%.

The Dow was up 2.36%, the S&P 500 gained 0.87% and the Nasdaq was up 0.33%.

ICI: Muni bond funds see $2.3B inflow
Long-term municipal bond funds and exchange-traded funds saw combined inflows of $2.307 billion in the week ended May 20, the Investment Company

Institute reported Wednesday.



In the previous week, muni funds saw inflows of $937 million, ICS said.

Long-term muni funds alone had an inflow of $1.625 billion in the latest reporting week after an inflow of $622 million in the week ended May 13.
ETF muni funds alone saw an inflow of $682 million after an inflow of $315 million in the prior week.

Taxable bond funds saw combined inflows of $16.170 billion in the latest reporting week after inflows of $14.572 billion in the prior week.

ICI said the total combined estimated inflows from all long-term mutual funds and ETFs were $5.609 billion after outflows of $4.045 billion in the previous week.

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