THE BOND BUYER

As Fed supports short end and issuers focus long, the belly of the curve is ignored

By

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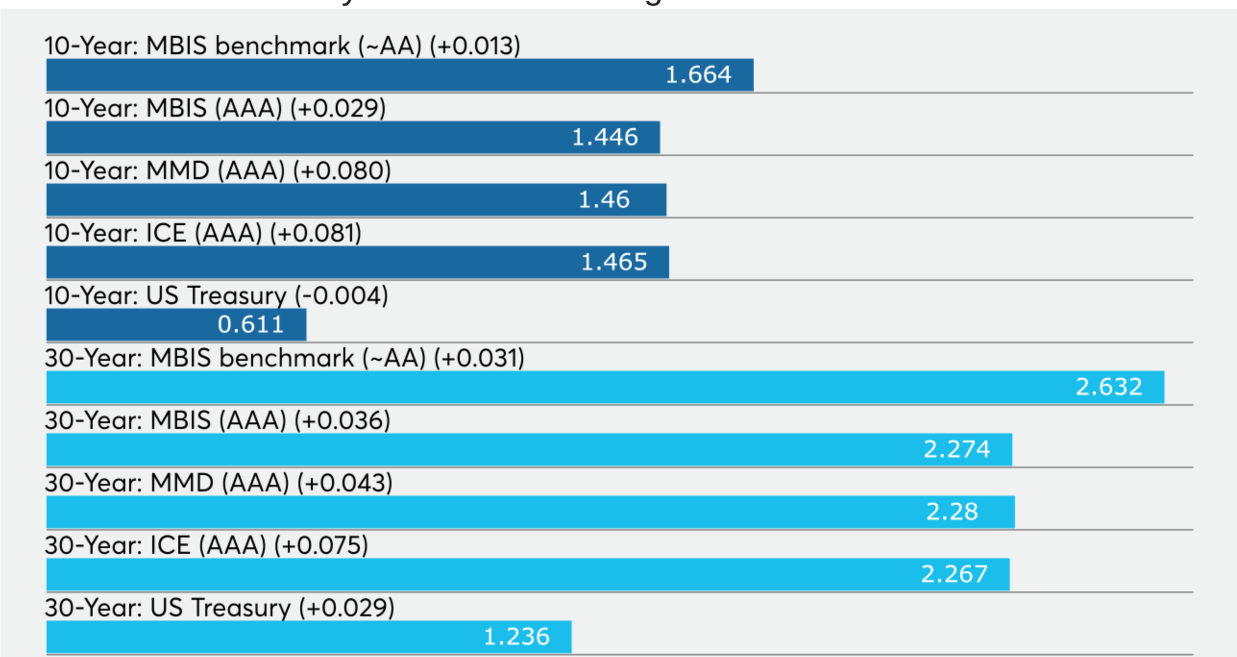
The belly of the municipal yield curve is experiencing little constructive activity as participants rely on the Federal Reserve for short-end support and put their trust in the ultimate recovery of issuers with long-end investment.



MBIS indices are updated hourly on the Bond Buyer Data Workstation

The primary digested a massive $1.12 billion bond offering from New York Power Authority. The entire deal was structured to mature later than 2045 and a good portion of it was designated green bonds. The deal repriced to lower yields by three basis points in 2045 and one to two in maturities from 2055 to 2060.

“I think the long end is probably off the same amount as the belly, but the bid-ask spread is miles wide so there is relatively no activity to judge it on,” a New York trader said. “Flows have slowed to a trickle — a lot of these guys don’t know what to do right now and I certainly don’t blame them.”

The Investment Company Institute reported $624 million in the week ended April 22.

“A major bear steepener is in play for the market as wider spreads force generic benchmarks up in yield,” said Kim Olsan, senior vice president at FHN Financial. “After seeing aggregate adjustments of 25 basis points in the intermediate range over the last week, the curve slope is now 141 basis points, its steepest since February 2019.”

She noted however that one distinction is that current rates are about 75 basis points lower from the 2019 period, which is incenting inquiry out the curve to reach specific yield targets.

“These forces are evident in both the new-issue and secondary markets, where the curve is becoming chunked out in a few major spots that are capturing the bulk of flows,” she said. “In the very short end trade flows are capturing nearly 20% of the volume, in reaction to daily and weekly floater that remain at nominal yields.”

Olsan isn’t the only one calling a bear steepener market.

“First and foremost, of course, are credit concerns stemming from the impact of COVID-19 and the implication on state and local entities,” said Greg Saulnier, municipal analyst at Refinitiv MMD.

Secondly, he said, supply remains in focus because of the several weeks in which it was absent, leading to a large backlog of day-to-day deals that may step off the sidelines and into the market at a moment’s notice.

“And finally, hedging – given the current disconnect between munis and treasuries, how does one properly hedge exposure? It seems as though all of the above have combined to cause a very hesitant and jittery bid side which has resulted in quality spreads widening and generic benchmark yields continuing to back up,” Saulnier said.

In secondary trading, the weakness was apparent.

Harford County 5s of 2021 traded at 1.16%-0.98%. New York EFCs, 5s of 2022, traded at 1.07%-1.02%. The yield on AAA benchmarks is in 2021 is 0.82%.

Wake County GOs, 5s of 2027 traded at 1.25%. Monday they were trading at 1.13% to 1.11%.

Ten-year Austin, Texas GOs, 5s of 30 were at 1.73%.

Katy Texas ISD, 4s of 2031, traded at 1.84%-1.75%. Original yield at pricing last week, 1.53%.

Northwest ISD 4 of 2034 yielded 2.14%-2.01% Original yield the week of April 13, 1.87%.

Going a bit further out the curve, El Paso Texas 4s of 2048 traded at 2.47% to 2.37%. Original pricing yield back in early January was 2.42%.

Two components appear to be the primary drivers as to where May’s trading is likely to start, Olsan said.

Supply will trickle in—some small, some large deals and buyers are dictating levels and spreads with expectations that after 10 years coupons ranging from 2% up to 5% will be used to address targeted needs.

“In a sign of what it’s taking for effective deal placement, a $167 million Fort Bend TX ISD issue effectively took PSF spreads up as much as 20 basis points,” she said.

Secondary trading is a function of hitting specific yield targets, 1% and 2% at the shortest possible terms.

“Anything in between those ranges is trading by appointment,” she said.

Credit weakness continues to affect trading

The range of credits that engulf potentially weakening scenarios is growing.

“Although expectations are that disruptions to revenue streams will be a months-long rather than years-long event, the severity of the near-term impacts is the big unknown,” Olsan said.

Moody’s estimates the collective impact to states will be $160 billion in the coming year.

Olsan said that a good proxy for the market’s mindset is the widening in California GOs. The spreads are double that of the new-issue just two weeks ago.

“With its Aa2/AA- rating, current spreads are 37 basis points above a 2015 issue when the state’s rating was Aa3/A+ and on parity with issuance from the period rated A1/A-,” Olsan said.

Buyers, she said, have been amply rewarded in the past by purchasing the state’s GOs at spread wides.

Defaults at 15 total

Meanwhile defaults are “typical” for the last full week of any month, however the week ended April 26 saw no municipal issuers disclose a first-time payment default, leaving the year-to-date total at 15 (or 14 excluding Puerto Rico), according to Municipal Market Analytics’ Default Trends report.

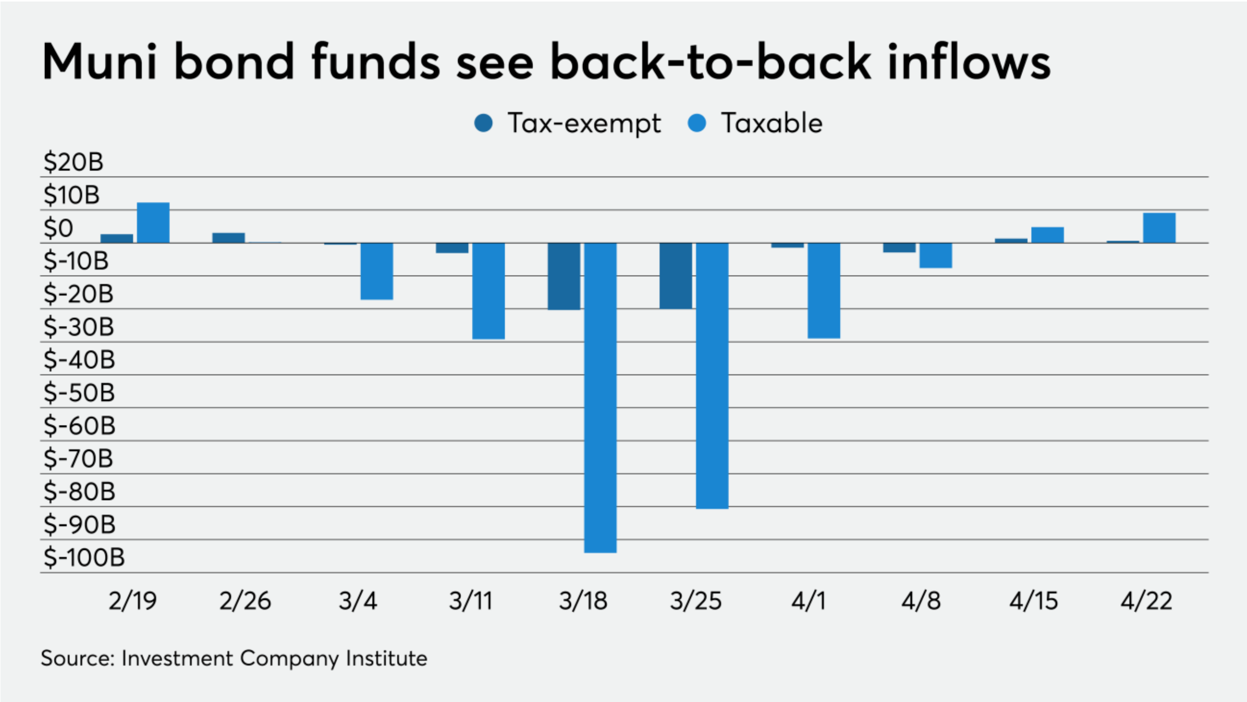
“Note that a (seemingly larger than typical) number of issuers have already announced imminent payment problems for the 5/1, 6/1, and 7/1 dates, but MMA will wait for those defaults to actually occur before adding them to YTD default totals,” the report said.

On the other hand, three more municipal borrowers—two retirement projects and a charter school—filed their first impairment notice last week, bringing the MTD impairment count to 18.

“No month has seen 20 or more impairments since the flurry of Puerto Rico filings in 2015, and more than two unrelated borrower impairments in a single month is a reasonable signal of market pressure,” the report said. “The universe of unique, currently impaired municipal borrowers is back above 700 for the first time since 4Q16.”

ICI reports inflows again

Long-term municipal bond funds and exchange-traded funds saw a combined inflow of $624 million in the week ended April 22, the Investment Company Institute reported on Wednesday.



It was the second consecutive week of inflows after seven weeks of outflows. The previous week, ended April 15, saw $1.314 billion of inflows.

Long-term muni funds alone had an inflow of $531 million after an inflow of $1.129 billion in the previous week; ETF muni funds alone saw an inflow of $93 million after an inflow of $185 million in the prior week.

Taxable bond funds saw combined inflows of $9.115 billion in the latest reporting week after revised inflows of $4.796 billion in the previous week.

ICI said the total combined estimated inflows from all long-term mutual funds and ETFs were $4.594 billion after inflows of $19.560 billion in the prior week.

The biggest laggard was world equities which saw an outflow of $7.933 billion this past week, after an outflow of $4.261 billion the week before.

Primary market

Goldman Sachs priced the Power Authority of the State of New York’s (Aa1/AA/AA/) $1.21 billion of revenue bonds.

The deal was priced as 4s to yield 3.00% in 2045, 4s to yield 3.08% in 2050, 4s to yield 3.22% in 2055 and as 4s to yield 3.36% and 3.25s to yield 3.53% in a split 2060 maturity.

“The loan was very attractive and did well,” said one Texas trader. “It was one to three times oversubscribed. I would think with the larger New York credits under duress that bringing a load with serial would have done well, especially since accounts are under exposed to the name.”

Secondary market data

Munis were weaker on the MBIS benchmark scale Wednesday, with yields rising by one basis point in the 10-year maturity and by three basis points in the 30-year maturities. On the MBIS AAA scale, munis were weaker with yields increasing by two basis points in the 10-year maturity and by four basis points in the 30-year maturity.

On Refinitiv Municipal Market Data’s AAA benchmark scale, the yield on the 10-year muni eight basis points higher to 1.46% and the 30-year increased five basis points to 2.32%.

The MMD muni to taxable ratio was 235.9% on the 10-year and 185.4% on the 30-year.

On the ICE muni yield curve late in the day, the 10-year yield was up eight basis points to 1.46% while the 30-year was higher by seven basis points to 2.67%.

The ICE muni to taxable ratio on the 10-year was 256% and the 30-year was 177%.

Muni/US Treasury ratios are at historic highs.

“Just one month ago the 10-year ICE muni curve/UST and 30-year ICE muni curve/UST ratios stood at 72% and 87%, respectively,” ICE said in a midday report.

“Weakness in shorter maturities of the investment grade muni market persists again today, with the ICE Muni Yield Curve inverting from 2021 vs. 2022. High-yield munis are broadly weaker across the board,” ICE said.

BVAL saw the 10-year increased four basis points to 1.42% and the 30-year rose seven basis points to 2.36%.

The IHS muni curve saw the 10-year rise to 1.42% and the 30-year increased to 2.25%.

Stocks were in the green as Treasuries were mostly lower.

The Dow Jones Industrial Average rose 2.57%, the S&P 500 index increased 2.97% and the Nasdaq was up 3.75%.

The three-month Treasury was yielding 0.102%, the Treasury two-year was yielding 0.199%, the five-year was yielding 0.353%, the 10-year was yielding 0.618% and the 30-year was yielding 1.237%.

Aaron Weitzman contributed to this report.

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