

## Muni Fortnightly

The markets are looking for signs of a fiscal deal from Congress to alleviate economic pain from the recession. Treasury yields were little changed in low volatility. Muni yields fell.

### PWM Fixed Income Research

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### Bottom Line

- Treasury yields little changed amid continued low volatility
- Muni yields fell more as ratios have declined.
- Muni funds experienced net inflows for 10<sup>th</sup> consecutive week.
- Moody's on airport credit dynamics, pension strains and budgetary flexibility
- S&P Puerto Rico Total Return Index +3.4% year-to-date.

### What happened in the bond markets last week?

Treasuries exhibited the low volatility that has been their defining feature for the past month. Nonetheless, yields leaned lower as equities were slightly higher and Covid-19 cases rose. Economic data (CPI, Empire Mfg., Industrial Production, Retail Sales) beat expectations (not sure how much salt to take with expectations) and showed sequential improvement (which wasn't hard to do). With relatively stable nominal yields, the change in yield has been based on storytelling. Real-yields have fallen and inflation breakevens have risen. For instance, in the past 30 days nominal yields fell only 5 basis points but real-yields fell 34 basis points and inflation breakevens rose 24 basis points. Risky asset volatility fell, corporate credit spreads tightened and municipal yields fell across the curve—marking the 11<sup>th</sup> consecutive week of positive returns for the ICE BAML Muni Index.

### Yield changes (week over week)

#### Treasuries

	Change (bp)	Yield (%)
<b>3 mo</b>	-2.1	0.10%
<b>1 year</b>	-0.3	0.14%
<b>2 year</b>	-0.8	0.15%
<b>5 year</b>	-1.9	0.28%
<b>10 year</b>	-1.3	0.62%
<b>30 year</b>	-0.8	1.32%

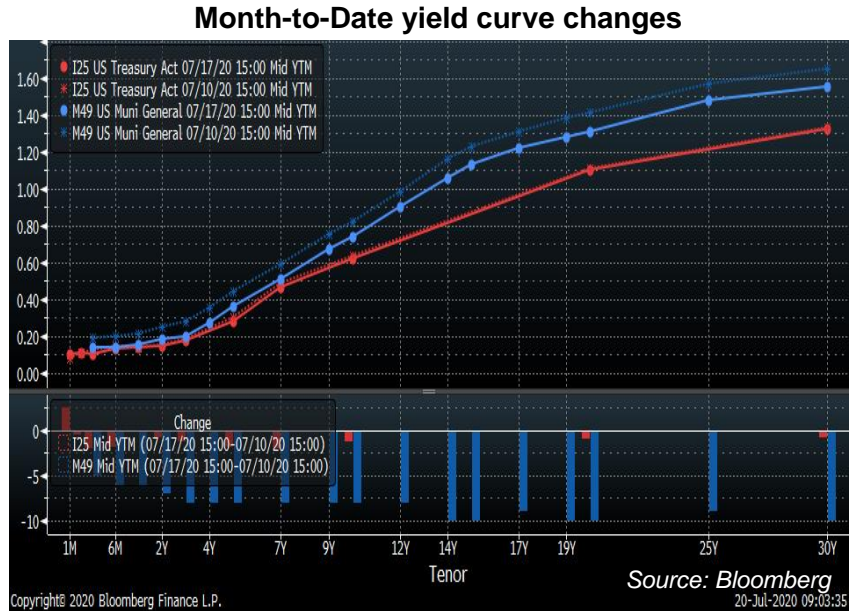
#### Munis (Bloomberg AAA GO)

	Change (bp)	Yield (%)
<b>2 year</b>	-7	0.18%
<b>5 year</b>	-8	0.36%
<b>10 year</b>	-8	0.74%
<b>30 year</b>	-10	1.55%

We can see changes in the bond market by looking at how rates have changed along the curve for both the **Treasury** curve and for the **AAA-rated G.O. Index** since last week.

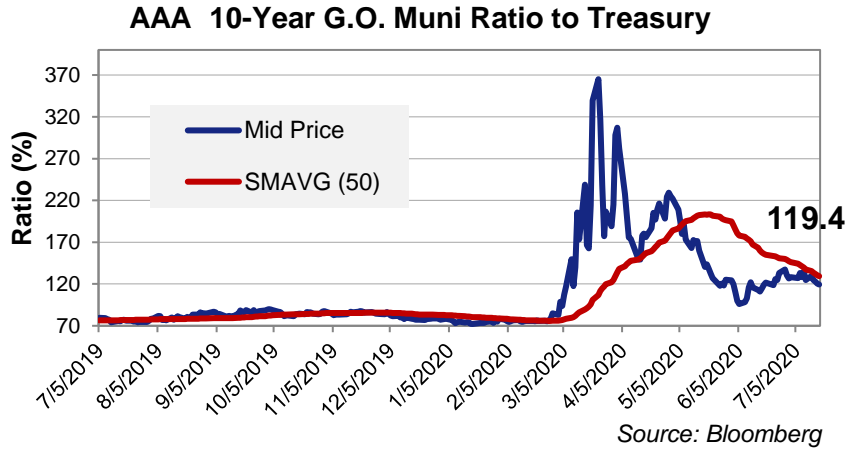
The Bloomberg chart to the right shows four yield curves: current and last week for both the Treasury curve (in red) and the muni AAA-rated G.O. Index (in blue).

The bottom panel shows changes in the rates along both curves for the week for both Treasuries and the AAA G.O. Index.

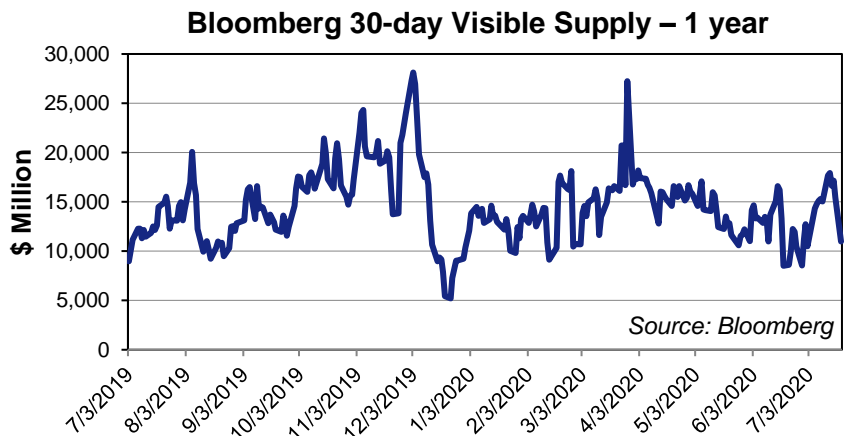


**10-yr AAA GO ratio lower at 119.4.**

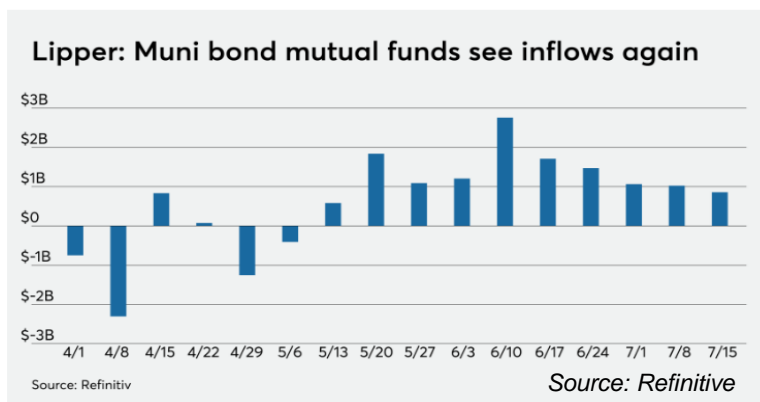
The line graph to the right shows the ratio of 10-year AAA-rated muni yields to the 10-year Treasury yield over the last year.



The **Bloomberg 30-Day Visible Supply** stands at \$11.0 billion down from \$17.7 billion this time last week. The YTD average visible supply is \$14.3 billion and the 12-mo average is \$14.7 billion.



**Muni Fund Flows:** According to Refinitiv Lipper, muni funds had net inflows last week; the 10th consecutive. Inflows amounted to \$857 million after \$1.0 billion of net outflows during the previous week. ETFs and high-yield funds also experienced large net outflows.



## Articles of Interest

**Challenges to Restoring Full Air Service (Moody's):** In a Sector Comment Moody's highlighted the challenges that airports face in restoring full service. One of the risks that airports have is high airline concentrations for instance: Dallas Airport Enterprise, Houston Hobby and Chicago Midway had 94% of passengers through Southwest Airlines; Atlanta Airport Enterprise had 73% of enplanements through Delta Airlines, Newark Liberty International Airport had 53% from United Airlines and Dallas-Fort Worth Airport had 68% of enplanements from American Airlines. Moody's expects that small airports in highly competitive markets to face service consolidation by larger airlines into larger airports.

**Recovery Led by Domestic Air Travel Hubs (Moody's):** Since mid-May and state re-opening efforts, air travel has been recovering about 2 percentage points of last year's levels each week (TSA data). Through June 29th, TSA screenings climbed to about 27% of last years' levels. At the nadir of the travel plunge, passenger volumes were down 95.5% on average from year-ago levels. Domestic connecting hubs and small airports were least impacted. International travel restrictions hit airports particularly exposed to those types of flights. Airports in the southern U.S. had been less impacted given their late imposition of stay-at-home orders but this could be reversed given the recent outbreaks in those regions.

**Most States Enacted Full Fiscal 2021 Budgets (Moody's):** While a vast majority of states enacted full-year budgets with only six adopting short-term plans, it highlighted the flexibility states have to address funding challenges. Keys to the budgets were **1**) expenditure cuts (to education, pensions etc.), **2**) federal aid already received and additional aid (while uncertain) and **3**) healthy reserve balances.

**Pension Tension (Moody's):** In a Sector In-Depth report, Moody's highlighted the rise in tension between pension funding and government budget constraints. Just as lower market yields and subdued investment returns boost the unfunded status of state and local governments the need for pension funding contributions will be strained by budgetary shortfalls. They highlight: **1**) pension affordability ratios will be worse for the next several years as state and local government revenues will suffer from the widespread decline in economic activity, **2**) lower investment return targets (below 7%) and actuarial determined contributions increases will continue to strain needs for contributions, and **3**) governments have less legal flexibility to alter pension and other retirement benefits will also create strain on contribution necessity.

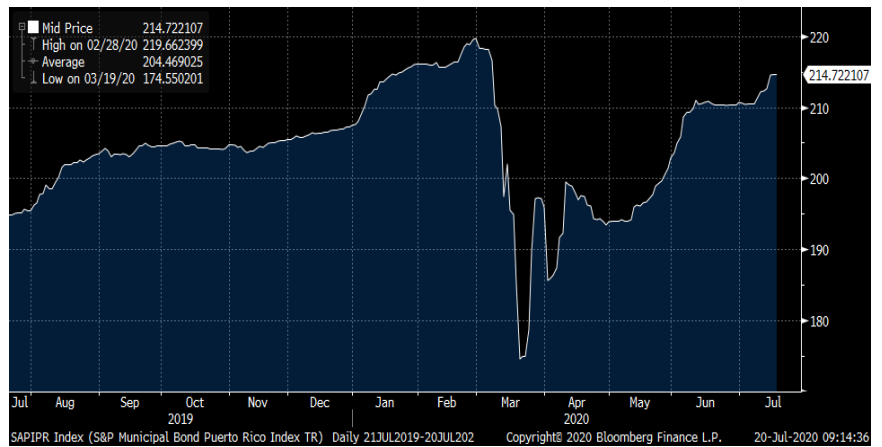
**Muni Defaults (Bloomberg Brief):** According to Municipal Market Analytics, 43 first-time defaults since the beginning of the year have occurred are more than what occurred in all of 2018.

## Puerto Rico

**Financial Oversight Board Wants More Time:** PROMESA the financial oversight board of Puerto Rico has asked for more time to negotiate debt restructuring with bondholders. The board had a July 15th deadline to submit a proposal but is asking for an extension till Sept. 11.

**The S&P Municipal Bond Puerto Rico Index:** finished at 214.7 vs. 210.6 at the beginning of July +1.96% and +3.43% YTD.

S&P Municipal Bond Puerto Rico Index Level (1-year)



Source: Bloomberg

## Relative Value by Maturity

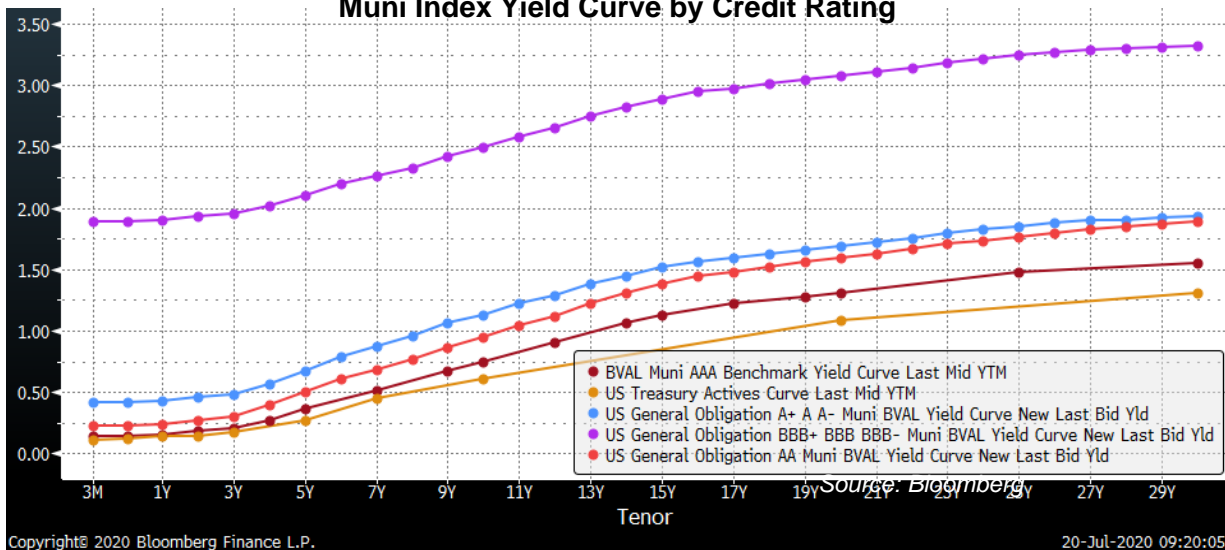
AAA Muni Ratios and Spreads by Maturity

7/20/2020 Maturity (yrs.)	Yield-to-worst (%)		0% Tax Rate		35% Tax Equivalent	
	AAA Gen. Oblig.	Treasury	Spread (bps)	Ratio (%)	Spread (bps)	Ratio (%)
1	0.15	0.13	2.0	114.5	10.2	176.2
2	0.19	0.14	4.5	131.8	14.5	202.8
3	0.20	0.17	3.5	120.9	14.4	186.1
4	0.27	0.21	6.7	132.4	21.3	203.7
5	0.36	0.27	8.5	131.5	27.7	202.3
7	0.51	0.45	5.6	112.5	32.9	173.1
10	0.74	0.61	13.2	121.8	52.9	187.3
15	1.13	0.78	35.0	144.9	95.8	222.9
20	1.31	1.08	23.0	121.3	93.4	186.6
25	1.47	1.19	28.0	123.5	107.2	189.9
30	1.55	1.30	24.1	118.5	107.4	182.3

Source: Bloomberg

## Relative Value by Rating

Muni Index Yield Curve by Credit Rating



Source: Bloomberg

For more information please contact your Financial Advisor.

## Appendix – Important Disclosures

Some of the potential risks associated with fixed income investments include call risk, reinvestment risk, default risk and inflation risk. Additionally, it is important that an investor is familiar with the inverse relationship between a bond's price and its yield. Bond prices will fall as interest rates rise and vice versa.

When considering a potential investment, investors should compare the credit qualities of available bond issues before they invest. The two most recognized rating agencies that assign credit ratings to bond issuers are Moody's Investors Service ("Moody's") and Standard & Poor's Corporation ("S&P"). Moody's lowest investment-grade rating for a bond is Baa3 and S&P's lowest investment-grade rating for a bond is BBB-. Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest).

The Bond Buyer 20-Bond Index consists of 20 general obligation bonds that mature in 20 years. The average rating of the 20 bonds is roughly equivalent to Moody's Investors Service's Aa2 rating and Standard & Poor's Corp.'s AA. The Bond Buyer 11-Bond Index uses a select group of 11 bonds in the 20-Bond Index. The average rating of the 11 bonds is roughly equivalent to Moody's Aa1 and S&P's AA-plus. The Bond Buyer Revenue Bond Index consists of 25 various revenue bonds that mature in 30 years. The average rating is roughly equivalent to Moody's A1 and S&P's A-plus. The indexes represent theoretical yields rather than actual price or yield quotations. Municipal bond traders are asked to estimate what a current-coupon bond for each issuer in the indexes would yield if the bond was sold at par value. The indexes are simple averages of the average estimated yields of the bonds, are unmanaged and a direct investment cannot be made in them.

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