MARKET INSIGHTS

Monthly Municipal Insight - February 29th

February 29, 2016 | Municipal Managers

John M. Loffredo, Robert A. DiMella

 

MacKay Municipal Managers Thoughts for the Month-End 2/29/16

AAA Municipal Yields

Municipal Yield	2/29/2016	Last Month	Last Year
2 YR	0.54%	0.68%	0.44%
5 YR	0.93%	1.04%	1.16%
10 YR	1.76%	1.75%	2.02%
30 YR	2.80%	2.77%	2.85%

Treasury Yield	2/29/2016	Last Month	Last Year
2 YR	0.80%	0.82%	0.65%
5 YR	1.24%	1.41%	1.54%
10 YR	1.76%	1.99%	2.04%
30 YR	2.64%	2.80%	2.63%

Muni/Tsy Ratio	2/29/2016	Last Month	Last Year
2 YR	67.5%	82.9%	67.7%
5 YR	75.0%	73.8%	75.3%
10 YR	100.0%	87.9%	99.0%
30 YR	106.1%	98.9%	108.4%

02/29/16. Past performance is no guarantee of future results. It is not possible to invest in an index.

Municipal bonds were largely unchanged during February as the Barclays Municipal Index generated a 0.19% return, the eighth consecutive month of positive returns. Munis underperformed both the Treasury and the Barclays U.S. Corporate indices. In fact, the ratio of Municipal to Treasury yields moved back above 100% with respect to maturities greater than 10 years. As a result, at these higher yield ratios, municipal bonds are attractive on a relative value basis.

With respect to supply, municipal bond issuance volume fell in the month of February as refunding volume dropped year-over-year. Lagging municipal bond performance reduced the benefits of refunding debt enough to be the primary cause for the decline in issuance. We believe this is temporary, and expect yield curves in both the Treasury market and the municipal market to flatten. Specifically, we anticipate that a flattening Treasury curve should lead to an increase in refunding activity as the year progresses (Source: Barclays).

February 2016 municipal bond fund flows continued the positive cash flow trend that has been in place since October, 2015, 21 consecutive weeks of positive inflows. Year-to-date (YTD), municipal bond mutual funds reported approximately $9.8B inflows, while equity funds continued experiencing negative flows, bringing their YTD total to $-35.7B Taxable fixed income funds have recently reversed their negative funds flows, posting $5.0B in positive flows during the past week, bringing their YTD flows to $-18.8B. (Source – Lipper, a Thomson Reuters Company*)

The continued stalemate with the State of Illinois budget negotiations caused significant collateral damage to Chicago Board of Education (BOE) bonds. After delaying a $875M bond offering in January, BOE issued a downsized $725M deal in February at distressed yield levels. Investors demanded a deeper discount to participate, causing yields to rise to 8.50%.

The distress that the decline in oil prices has caused on financial markets has not affected the municipal market in a significant way. While the municipal market is largely a “user” of oil, not a “producer” of oil, the decline has started to impact certain isolated credits. The states of Alaska and Louisiana were downgraded due to the economic pressures of the decline in oil prices as both states rely heavily on the energy industry for tax revenue. In addition, certain energy companies that issue in the municipal marketplace, such as Talen Energy Supply LLC and Marathon Oil Company, have seen their bonds drop significantly. We continue to believe these are isolated events, coming from issuers that do not have a significant amount of debt in the municipal market. On the positive side, low oil prices are leading to higher usage of toll roads and airports. This is in line with our 4th annual insight which noted that we believe the transportation sector will outperform in 2016.

**Lipper Disclaimer: Lipper data and information are for informational purposes only, and do not constitute investment advice or an offer to sell or the solicitation of an offer to buy any security of any entity in any jurisdiction. In addition, Lipper, a Thomson Reuters company, will not be liable for any loss or damage resulting from information obtained from Lipper or any of its affiliates.*

« Back to Insights
