



**Ronald Schwartz, CFA**

Managing Director,  
Senior Portfolio Manager,  
Tax-Exempt

Ron is a Senior Portfolio Manager focused on the Tax-Exempt Strategies. He has worked in the investment management industry since 1982. Ron received a B.A. in Business Administration from Adelphi University and is a CFA Charterholder and a member of the CFA Society of Orlando.



**Scott Andreson**

Director, Municipal Research

Scott is the Director of Municipal Research for Seix Investment Advisors. He has more than 17 years of investment experience. He earned his MPA from USC and is a current officer of the National Federation of Municipal Analysts.

**CONTRIBUTORS**

**Dusty Self**

Managing Director,  
Senior Portfolio Manager,  
Tax-Exempt

**Phillip Hooks, CFA**

Vice President,  
Municipal Credit Research

## Our Perspective

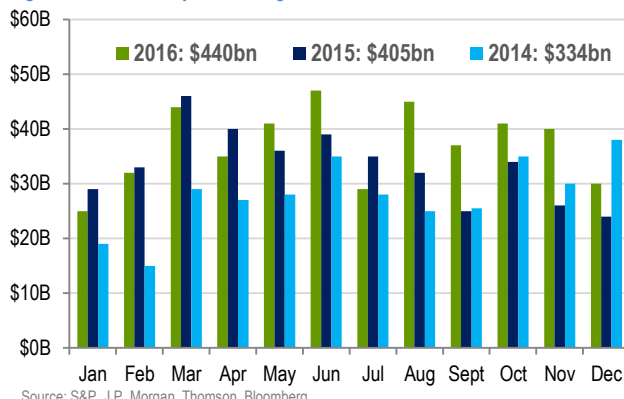
### END OF THE BULL RUN FOR MUNIS? - OCTOBER 2016

After a strong run of 14 straight consecutive months of positive returns, tax exempt bonds generated their first negative returns (-0.50%) in September. The central bank also recently indicated that the case for tightening monetary policy has strengthened. As a result, many of our clients have been asking us if we think the bull market for municipal bonds has ended. We believe that this is a temporary seasonal weakness dip caused primarily by a significant increase in issuance and not the start of a sustained bear muni market. Historically, the tax exempt market's technical conditions weaken in the fall months as supply increases, fund flows decline, and fewer coupon and principal reinvestments. The upcoming election, combined with recent statements of a possible rate increase by the Fed, is most likely enhancing the seasonally weak technical conditions.

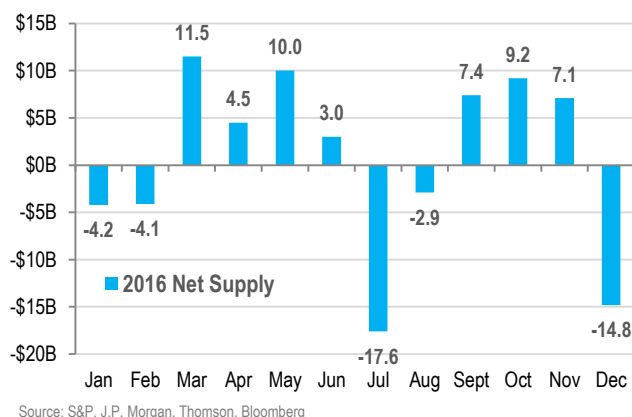
#### Record Issuance in 2016?

Muni volume set an all-time monthly record in September and supply will likely remain robust through November as issuers rush to take advantage of record low rates. This year's increase in new money issuance now brings the current size of the muni market to an all-time high, eclipsing the peak set in the fourth quarter of 2010, and is currently running \$100 million higher than the five year average. Gross municipal bond supply is now conservatively projected at \$440 billion for 2016, which will exceed the \$433bn record set in 2010 (see Exhibit 1). However, by December, the technical conditions are projected to improve as net supply becomes negative (see Exhibit 2).

**Exhibit 1: Gross supply is forecast to be \$440bn in 2016, \$100bn higher than the five year average**



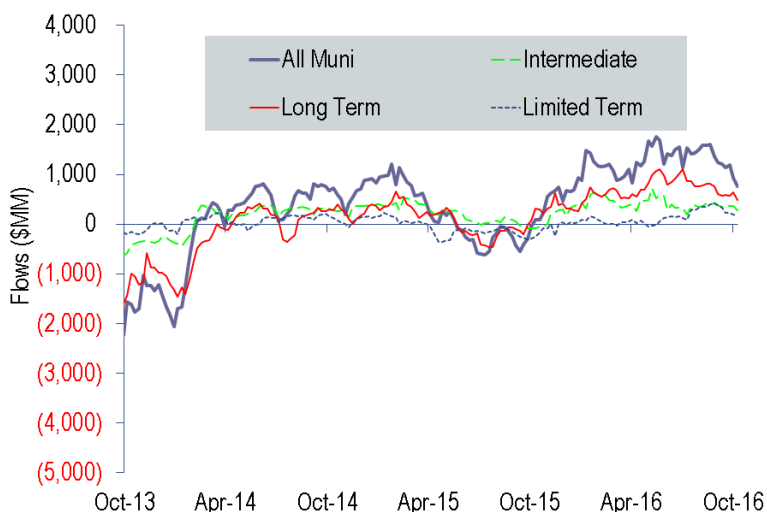
**Exhibit 2: Net supply is expected to turn supportive of municipal outperformance in December following positive net supply of +\$16bn in October and November**



### Strong Tax Exempt Fund Flows in 2016

Demand has been solid this year with a run of 54 weeks of positive mutual fund flows for a cumulative \$60.2 billion that just recently ended. While muni fund flows have recently slowed to their lowest weekly total since last November, and have actually turned negative for tax exempt high yield funds, this is not uncommon for this time of year (see Exhibit 3). Stock market volatility, negative interest rates overseas, and the recent cheapening of muni/Treasury ratios are likely to continue to bring in crossover and foreign buyers into our asset class, which will help to somewhat mitigate the seasonal slowing of fund flows.

**Exhibit 3: Municipal fund flows: 4 week moving averages**



Source: Citi Research, Lipper

The recent correction has presented a better buying opportunity after the summer's strong market technical factors led to rich valuations that did not reflect the softening of domestic fundamental conditions. We have been upgrading our portfolios and raising cash over the past few months in anticipation of a fall seasonal correction and now plan to take advantage of the current cheap market conditions. Our call continues to be that long term rates will remain lower for longer, regardless of any possible Fed actions later this year. As a result, we remain constructive on the municipal sector because of its tax exempt income, attractive Treasury ratios, and very compelling yields compared to other global fixed income rates.

The assertions in this perspective are Seix Investment Advisors' opinion.

**Investment Risks:** All investments involve risk. Debt securities (bonds) offer a relatively stable level of income, although bond prices will fluctuate providing the potential for principal gain or loss. Intermediate-term, higher-quality bonds generally offer less risk than longer-term bonds and a lower rate of return. Generally, a portfolio's fixed income securities will decrease in value if interest rates rise and vice versa. A portfolio's income may be subject to certain state and local taxes and, depending on your tax status, the federal alternative minimum tax. There is no guarantee a specific investment strategy will be successful.

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