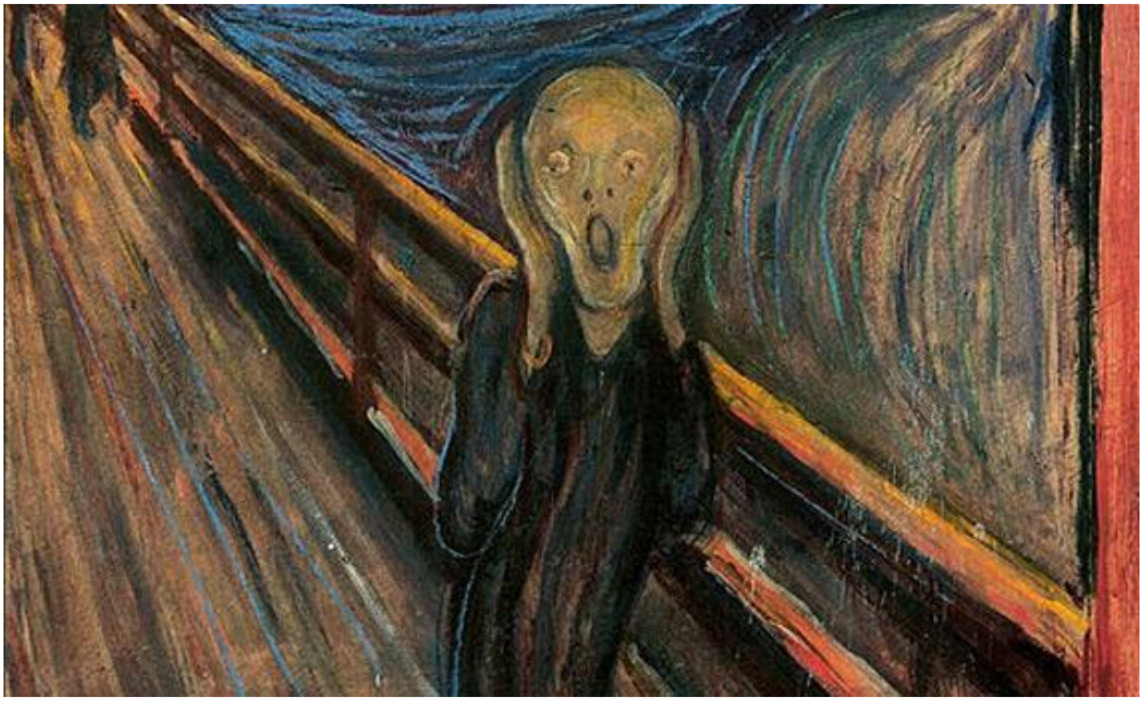
Municipal Rundown 2/22/16

I ❤ Munis!

The Municipal bond market has generally been insulated from recent global market turmoil and falling oil prices. Muni strength can be attributed to a weaker equity market, a stable interest rate view that seems to be “Fed status quo”, low inflation expectations, improving credit quality and tight new issue supply.

According to Morningstar one-year trailing numbers, municipal bonds as measured by the Barclay’s Municipal Bond Index were up 3.3% through February 2nd 2016. Take a look at how some other asset classes fared over the same period:

Large-cap blend	-5.85%
Mid-cap bend	-9.06%
Small-cap blend	-9.39%
Tactical allocation	-8.49%
World allocation	-7.26%
World stock	-7.91%
Emerging markets	-18.93%
Long-term government bond	-4.08%
Short-term bond	-0.22%
Real estate	-7.01%
Precious metals	-29.53%
Energy master limited partnerships	-41.01%



How many investors went 100% munis a year ago? Not enough. The S&P 500 is down 6.22% YTD. Intermediate munis are up 1.23%. Corporate bonds are up 1.98% this year, but down 4.68% over the last twelve months.

Munis have performed well amidst havoc in equity and corporate bond markets, remaining fairly uncorrelated with those situations. The muni market is a pure play on the U.S., without exposure to China, Europe, or even oil in most cases. The vast majority of states are not feeling any impact from the pain of cheap oil. The handful with some exposure are making budgetary adjustments and working through it.

State tax revenue collections have continued to be solid; only one quarter without growth in more than five years. Overall fiscal conditions are improving. We expect property tax and income tax collections to be supported by gradual and continuous growth in the real estate and job markets.

Municipal defaults are decreasing, with only four Chapter 9 bankruptcies in 2015.

Technicals:

New muni supply in 2016 is estimated to be similar to last year's $429 billion. We can expect fewer refundings, but an uptick in the issuance to address infrastructure needs.

Municipal fund flows have continued to be modestly positive for the last 19 weeks. There seems to be ample cash on the sidelines, waiting for an opportunity to be invested.

Consider the following muni mutual fund flow data:

2013 -$58 billion

2014 +$28 billion

2015 +$15 billion

Coming Up Next:

Volatility in 2016 is likely to be driven by the external factors described earlier, but may also occur in reaction to headline-grabbing, slow moving train wrecks like Puerto Rico, Chicago and Illinois.

Fortunately at this point investors seem to have largely differentiated between Puerto Rico and the muni market overall. The Commonwealth has defaulted on some agency debt and continues to seek a restructuring. In the meantime, painful cuts in services are taking place on the island - laying off public employees, slashing public transportation, not paying bills to suppliers. Hedge funds and mutual funds with PR exposure now have made their bets - understanding that there may be a haircut coming. It's likely to drag on all year, and hopefully will have minimal impact on the market overall.

Closer to home, Chicago Board of Education recently issued 10yr bonds at an astounding 7.75%, and long bonds at 8.50%. That's what it took for this Moody's B+ rated issue to clear the market after drawing down its reserves and shortchanging pensions for years. The Chicago Public School system has financially collapsed. The Chicago teachers union recently voted against a compromise agreement that their own leadership had negotiated. The Governor is threatening takeover. We have avoided this credit and will continue to do so.

Riverbend Capital:

We continue to favor higher quality, intermediate premium coupon callable bonds for their yield advantage and defensive characteristics. However, each portfolio is customized according to investor objectives and parameters.

Please feel free to contact us anytime if you'd like to discuss the topics cited in this update, or any others related to the municipal bond market.

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