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Monthly Municipal Market Update

Month in review

The AAA MMD yield curve experienced a bull flattener during February, with yields declining by 10–28 basis points (bps) across the curve. Notably, yields were sub-1.00% out to the 11-year tenor as of 28 February, compared to sub-1.00% levels out to just the seven-year tenor as of 31 January.¹ February municipal bond issuance of \$36.5 billion represented a slight uptick from January’s \$31.4 billion total issuance (see Figure 2) and contributed to the highest February year-to-date (YTD) issuance of the past decade. Over 25% of the month’s total new issuance was attributable to taxable municipal debt, whereas new money and refundings contributed almost evenly to February total issuance — accounting for \$18.5 billion and \$15.5 billion, respectively.²

- On the final business day of February, Federal Reserve Chair Jerome Powell signaled the rate-setting committee’s willingness to cut short-term interest rates. The Fed’s response came in the face of the global economic slowdown resulting from fear surrounding the spread of COVID-19. These remarks served as a foreshadowing of the central bank’s eventual 50 bps rate cut, announced on 3 March following its first emergency policy meeting since the 2008 financial crisis.³

- Municipal bond indices experienced yet another month of strong performance, following sustained demand for the asset class. In February, the Bloomberg Barclays Municipal Bond Index returned 1.29% and the Bloomberg Barclays High Yield Municipal Bond Index returned 2.11%.⁴
- Muni/Treasury ratios increased across the curve in February (see Figure 3). The one-year ratio ended the month at 73% (up from 57%), the two-year ratio at 83% (up from 62%), the five-year ratio at 80% (up from 63%), and the 10-year ratio at 82% (up from 76%).⁵
- February’s primary market issuance of \$36.5 billion — approximately \$9.5 billion of which was taxable municipal issuance — represented a 16.4% increase from January 2020 and a 38.4% increase compared to February 2019.⁶
- Secondary market trading was relatively slow in February, with its 617,000 total trades marking the second-lowest figure of the post-crisis era. Despite this notable low, par traded was fairly unremarkable, amounting to \$238 billion, a figure nearly equal to the trailing three-year monthly average.⁷

Figure 1: Market snapshot

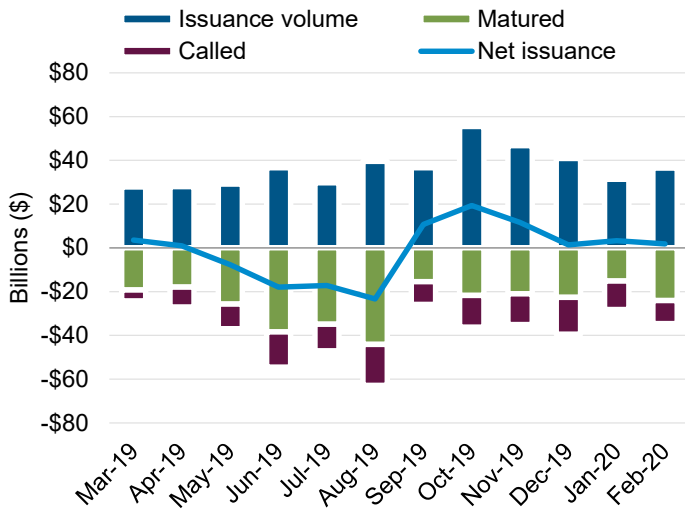
Muni yields (MMD AAA)			U.S. Treasury yields			Muni taxable equivalent		
	Yield	MTD change	YTD change	Yield	MTD change	YTD change	Yield	Spread
2-year	0.73%	-0.10%	-0.31%	0.88%	-0.45%	-0.68%	1.23%	0.35%
5-year	0.73%	-0.11%	-0.36%	0.91%	-0.42%	-0.77%	1.23%	0.32%
10-year	0.93%	-0.22%	-0.51%	1.14%	-0.38%	-0.77%	1.57%	0.43%
30-year	1.52%	-0.28%	-0.57%	1.65%	-0.36%	-0.73%	2.57%	0.92%

\$67.9B	+\$5.2B	\$23.7B	3.11%	4.62%	-51bps	-77bps
YTD muni issuance	M/M muni issuance	YTD muni fund flows	YTD IG return	YTD HY return	YTD change in 10yr muni yield	YTD change in 10yr Treasury yield

Yields and spreads: Thomson Reuters. Taxable equivalent yield assumes 37% federal income tax and 3.8% Medicare investment tax. Spread refers to spreading the municipal taxable equivalent yield against the U.S. Treasury yield. Monthly new issuance: The Bond Buyer Data. Muni fund flows: Refinitiv Lipper. YTD IG return: Bloomberg Barclays Municipal Bond Index. YTD HY return: Bloomberg Barclays High Yield Municipal Bond Index. All data as of 29 February 2020.

Muni technicals in focus: Yields plunge to historical lows in the face of COVID-19

Figure 2: Overall market net supply

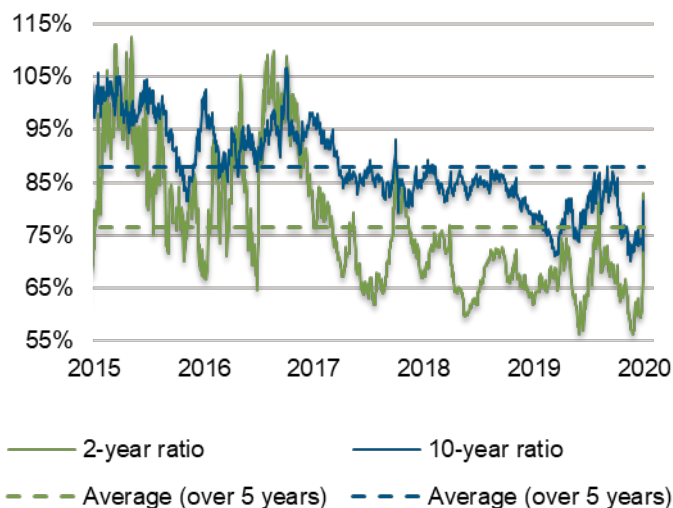


Source: Maturity and called data, Bloomberg; issuance data, The Bond Buyer. All data as of 29 February 2020

Continuing municipal yields’ monthlong descent, the 10-year AAA municipal yield closed February at a record low of 0.93%.⁸ The 10-year Treasury yield also collapsed over the course of the month, reaching an unprecedented low of 1.14%.⁹ As falling yields translate to price appreciation, the Bloomberg Barclays Municipal Bond Index delivered a gain of 1.29% in February, the fifth straight month of positive returns for the municipal market.¹⁰

Heavy retail demand continued to outstrip supply — a seasonal trend continuing from January — despite a relative pickup in issuance. Municipal bond funds saw an approximate \$12.2 billion

Figure 3: Municipal/Treasury ratio



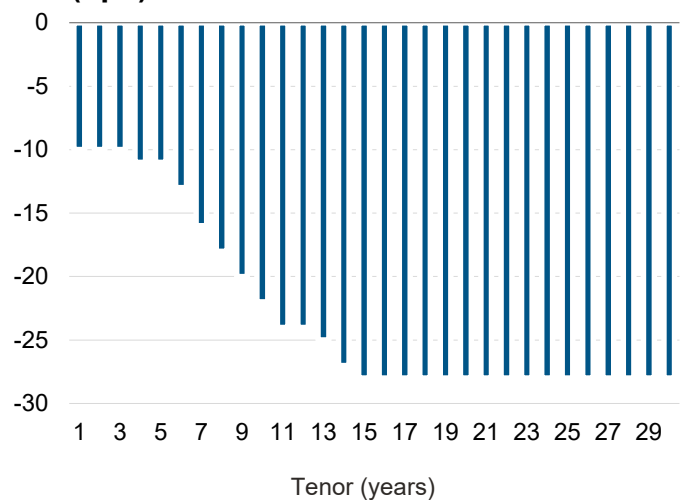
Source: Thomson Reuters TM3 MMD Interactive as of 29 February 2020

influx over February, including the highest weekly inflow of the past decade, \$5.6 billion.¹¹ Tax-exempt and taxable new issuance grew by \$26.75 billion and \$9.54 billion in February, respectively.¹² Demand for taxable new issuance persisted, due in part to foreign and institutional investor interest.

Against the backdrop of robust municipal technicals, a flight to safety spurred by coronavirus concerns was a notable driver in February’s decline in yields. We continue to diligently monitor the potential impacts of COVID-19 on municipal credit quality. Given the uncertainty due to a lack of timely and reliable data, we cannot currently project to what extent various obligors will bear financial costs or loss of economic activity. Historically, however, state and local governments have experienced a quick recovery from the significant spending pressures and loss of economic activity caused by earthquakes, hurricanes, and flooding.

We believe many of the same strengths that buffered municipalities during the aftermath of natural disasters will similarly serve to stabilize these credits should COVID-19 cases continue to spread in the United States. Within the sectors we anticipate being most immediately impacted by the virus (e.g., seaports, nonprofit healthcare), we believe there is a wide spectrum of credit quality. Examples of strong obligors include a seaport well-positioned to handle diminished passenger or cargo volume and the subsequent lost revenue, or a hospital prepared for increased patient demand. As with most municipal credit risks, we find that prudent credit selection and continued surveillance are the best defense against emerging risk.

Figure 4: Month-over-month change in MMD yields (bps)



Source: Thomson Reuters TM3 MMD Interactive as of 29 February 2020

Figure 5: Market data

Municipal index returns

Muni returns	YTW	MTD	YTD
Bloomberg Barclays Muni Index	1.27%	1.29%	3.11%
Bloomberg Barclays 1–10 (1–12)	0.99%	0.72%	2.02%
Bloomberg Barclays Muni Short (1–5)	0.90%	0.35%	1.03%
Bloomberg Barclays High Yield Muni	3.29%	2.11%	4.62%

Source: Bloomberg Barclays as of 29 February 2020

Monthly municipal fund net flows (in millions)

Month	2020/2019	2019/2018	2018/2017
September	\$6,651	(\$168)	\$1,443
October	\$5,600	(\$3,800)	\$346
November	\$9,000	(\$5,410)	\$1,640
December	\$9,568	(\$1,972)	\$383
January	\$11,500	\$3,906	\$3,391
February	\$12,200	\$8,439	\$2,227

Source: Refinitiv Lipper as of 29 February 2020

Average monthly visible supply (in millions)

Month	2020/2019	2019/2018	2018/2017
September	\$11,945	\$7,934	\$10,535
October	\$13,950	\$8,888	\$11,250
November	\$15,275	\$7,164	\$11,242
December	\$11,295	\$6,331	\$13,286
January	\$10,115	\$7,452	\$6,832
February	\$10,801	\$6,991	\$6,610

Source: Bloomberg as of 29 February 2020

Secondary market activity (in millions)

Month	Average par of Bloomberg pick	Average daily bid wanted
Feb-19	\$14,013	\$848
Mar-19	\$18,886	\$828
Apr-19	\$18,146	\$767
May-19	\$17,071	\$774
Jun-19	\$19,118	\$820
Jul-19	\$16,320	\$474
Aug-19	\$12,712	\$630
Sep-19	\$15,540	\$743
Oct-19	\$15,486	\$562
Nov-19	\$11,851	\$562
Dec-19	\$10,752	\$529
Jan-20	\$11,017	\$597
Feb-20	\$7,481	\$582

Source: Bloomberg as of 29 February 2020

10-year municipal vs. 10-year Treasury yields

Day	Municipal	Treasury
1/31/2020	1.15%	1.52%
2/29/2020	0.93%	1.14%

Source: Thomson Reuters as of 29 February 2020

Monthly new issuance (in millions)

Month	2020/2019	2019/2018	2018/2017
September	\$36,556	\$25,220	\$29,696
October	\$55,544	\$36,585	\$40,099
November	\$46,680	\$27,846	\$45,430
December	\$40,787	\$21,965	\$69,827
January	\$31,366	\$24,968	\$21,506
February	\$36,514	\$26,375	\$17,895

Source: The Bond Buyer, including bond and note issuance, as of 29 February 2020

Monthly bond redemptions (in millions)

Month	Amount matured	Amount called
Mar-19	\$19,271	\$4,970
Apr-19	\$17,895	\$9,093
May-19	\$25,753	\$11,146
Jun-19	\$38,419	\$16,118
Jul-19	\$34,915	\$12,114
Aug-19	\$44,123	\$18,747
Sep-19	\$15,521	\$10,275
Oct-19	\$21,783	\$14,425
Nov-19	\$21,026	\$13,991
Dec-19	\$22,607	\$16,803
Jan-20	\$15,207	\$12,947
Feb-20	\$24,072	\$15,253

Source: Bloomberg as of 29 February 2020

Sector returns (in %)

Select sectors	Feb '20	YTD	2019
General obligation	1.22%	3.02%	7.30%
Pre-refunded	0.32%	0.96%	3.55%
Revenue	1.39%	3.32%	7.93%
Education	1.35%	3.27%	8.00%
Healthcare	1.63%	3.65%	8.69%
Industrial development	1.35%	3.03%	8.44%
Lease-backed	1.49%	3.58%	8.46%
Power	1.22%	2.82%	7.04%
Special tax	1.34%	3.39%	7.82%
Transportation	1.45%	3.41%	7.89%
Water & sewer	1.22%	3.06%	7.29%
HY tobacco	4.58%	7.31%	11.60%
HY Puerto Rico	2.27%	8.01%	20.03%

Source: Bloomberg Barclays Index as of 29 February 2020

¹ Thomson Reuters TM3 MMD Interactive Data, 29 February 2020

² The Bond Buyer: Primary Market Statistics – A Decade of Bond Finance, 29 February 2020

³ Nick Timiraos, “Federal Reserve Will ‘Act as Appropriate to Support Economy,’” The Wall Street Journal, 28 February 2020; Nick Timiraos, “Federal Reserve Cuts Rates by Half Percentage Point to Combat Virus Fear,” The Wall Street Journal, 3 March 2020

⁴ Bloomberg Barclays, 29 February 2020

⁵ Thomson Reuters TM3 MMD Interactive Data, 29 February 2020

⁶ The Bond Buyer: Primary Market Statistics – A Decade of Bond Finance, 29 February 2020

⁷ SIFMA: US Municipal Trading, 3 February 2020; The Bond Buyer: Secondary Market Data, 29 February 2020

⁸ Thomson Reuters TM3 MMD Interactive Data, 29 February 2020

⁹ Ibid.

¹⁰ Bloomberg Barclays, 29 February 2020

¹¹ Refinitiv Lipper, 29 February 2020

¹² The Bond Buyer: Primary Market Statistics – A Decade of Bond Finance, 29 February 2020

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