RIVERBEND
Capital Advisors

Municipal Bond Rundown 7/21/15

July Market Brief: Fund Flows, Mid-year Rollover, Puerto Rico

So Far in 2015

As measured by the broad market Barclays Municipal Bond Index, munis were essentially flat in the first half of this year (up .11%). However, munis did beat the Dow (up .03%) over the same period! Muni performance has been impacted by Fed interest rate conjecture as well as renewed focus on high profile, extreme negative credit circumstances: Puerto Rico, Chicago and Illinois.

Notable Development

Muni note issuance is down substantially in 2015, as several states are running large budget surpluses and have no need to issue notes as a cash flow bridge to tax collections. California is an example, passing this year on what had become the state's annual Revenue Anticipation Note pricing. The last time California did not issue RANs, the 1990's tech boom was in full swing. Texas is not tapping the note market for the first time in 30 years!

Technically Speaking

The market is currently in the midst of unusually heavy new issue supply for this time of year. Additionally, municipal bond mutual funds have been seeing fairly consistent outflows since April, reducing overall YTD inflow to $7.5 billion according to Lipper. While these factors have weighed on the market, the expectation for August is decline in net muni supply of $16 billion - given large anticipated maturities and a tapering of new issuance.

Puerto Rico

This situation evolves every day. Puerto Rico has approximately $73 billion in outstanding debt, which is the highest per capita in the United States. The island's population has declined 7% over the past decade and is now 3.5 million. Puerto Rico's economy has contracted nearly every year since 2006. Official unemployment hovers near 15%. It's a tough one.

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Last week the Commonwealth conducted debt resolution talks with some of it's creditors. Questions surround how existing obligations may be altered, the way general obligations will be treated vs. debts of various agencies and authorities, whether maturities could be extended, if Chapter 9 bankruptcy legislation can advance through Congress, and how substantial might potential haircuts applied to principal have to be so that debt service would become sustainable.

A Look Ahead

Volatility is likely to continue in the second half of 2015 as the market reacts to negative developments emanating from a handful of high profile issuers. For example, muni fund redemptions spiked recently when Puerto Rico's Governor declared the Commonwealth's debts "not payable".

It's important to keep in mind that the situations in Puerto Rico, Chicago, Illinois, and other troubled, high profile credits are issuer *specific* and not market *systemic*. The municipal bond market is broad and heterogeneous, comprised of a wide range of issuers who vary by geography, sector and credit quality.

The “risk on, risk off” cycle seems to repeat itself in the muni market. One approach is to seize on sporadic potential overreactions to developments that should not come as a surprise, but still manage to generate market anxiety. Know when to ignore the noise.

For those with a longer-term investment horizon, we continue to favor high quality, premium coupon bonds with intermediate maturities, as this structure is more defensive in a rising rate environment.

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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