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Private Wealth Management

Muni Fortnightly

Treasury yields mixed with curve steepening. Muni yields fall, relatively richening. Moody's puts State and Local government sectors on negative credit outlook.

PWM Fixed Income Research

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Bottom Line

- Treasury yields fell sharply amidst continued volatility in all paper asset markets.
- Muni funds experienced the first net inflows since February.
- Moody's comments on the CARES Act impact of various muni sectors.
- Municipal Liquidity Facility to aid short-term municipal liquidity constraints.
- Illinois (rated Baa3) put on Negative Outlook.
- S&P Puerto Rico Total Return Index -4.9 % year to date.

What happened in the bond markets last week?

As risky asset markets continue to look askance at the economic data with the expectation that the destruction is temporary, Treasury yields too have seemingly found an asymptotically low level on the short-end of the curve while the longer-end steepens – steepest since mid-March. It is possible that the longer-end is being pressured to some degree by the sheer degree of the issuance to fund the budget deficits in governments. The short-term funding markets continue to thaw with LIBOR-OIS spreads continuing a steady retreat and the commercial paper rates have dropped.

Municipal bond yields acted with more stability during the last half of the two week period, falling and relative value richening.

Yields during the last two weeks

Treasury yields were mixed with the curve steepening:

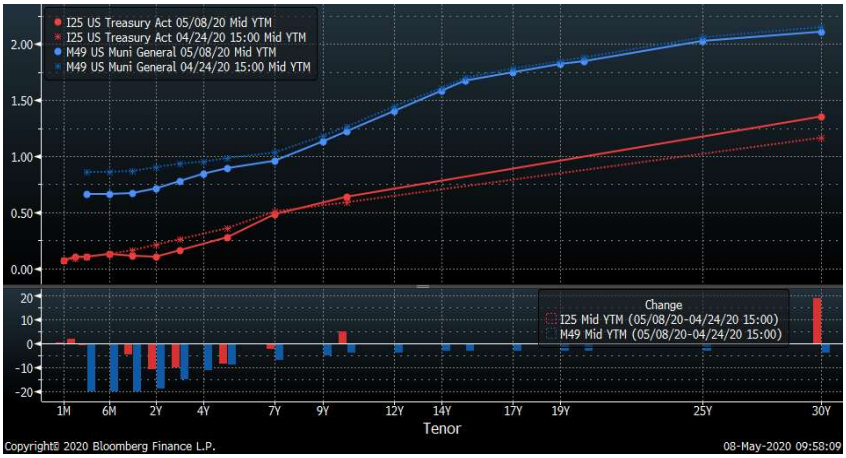
3-month	-1 bps to 0.10%
1-year	-4.5 bps to 0.12%
2-year	-10.6 bps at 0.16%
5-year	-8.3 bps at 0.28%
10-year	+4.8 bps at 0.64%
30-year	+18.8 bps at 1.35%

Bloomberg **Municipal** Index yields fell across the curve:

(AAA-rated GO)

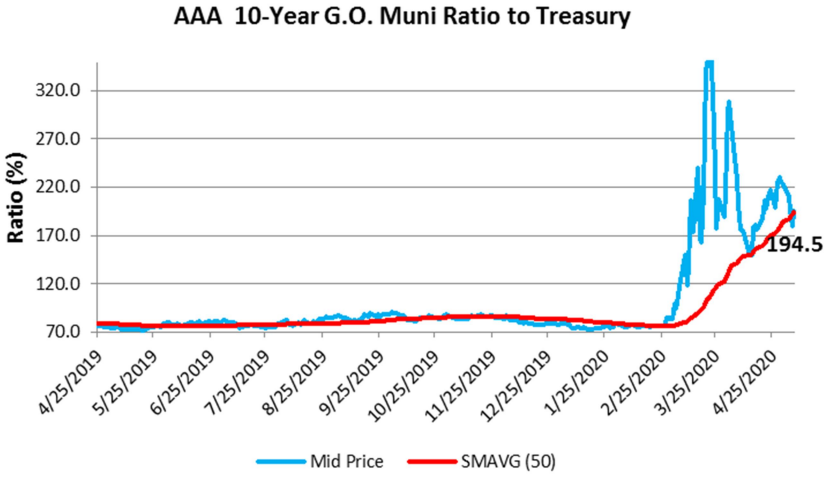
2-year	-19 bps to 0.71%
5-year	-9 bps at 0.89%
10-year	-4 bps to 1.22%%
30-year	-4 bps at 2.11%

Month-to-date Yield Curve and Muni Curve Changes



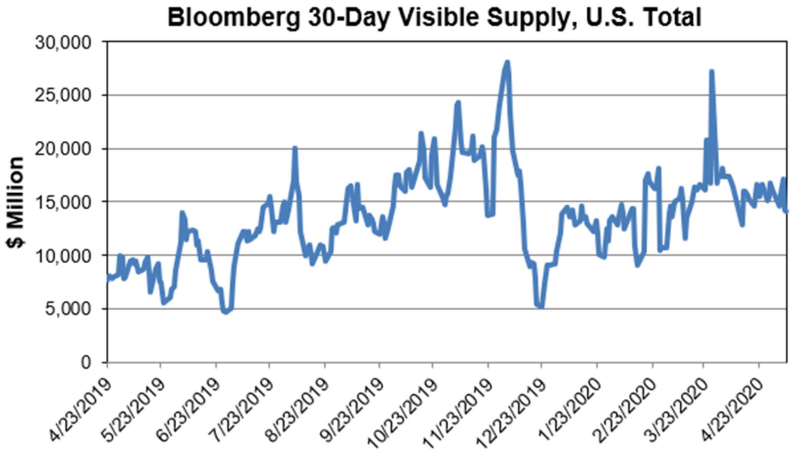
Source: Bloomberg

10-yr AAA GO ratio lower at 194.5. We can observe changes in the bond market by looking at how rates have changed along the curve for both the Treasury curve and for the AAA-rated G.O. Index since last week. The Bloomberg chart on page 1 shows four yield curves: current and last week for both the Treasury curve and the AAA-rated G.O. The bottom panel of the Bloomberg chart shows changes in the rates along both curves for the week for both Treasuries and the AAA G.O. Index. The line graph to the right shows the ratio of 10-year AAA-rated muni yields to the 10-year Treasury yield over the last year.



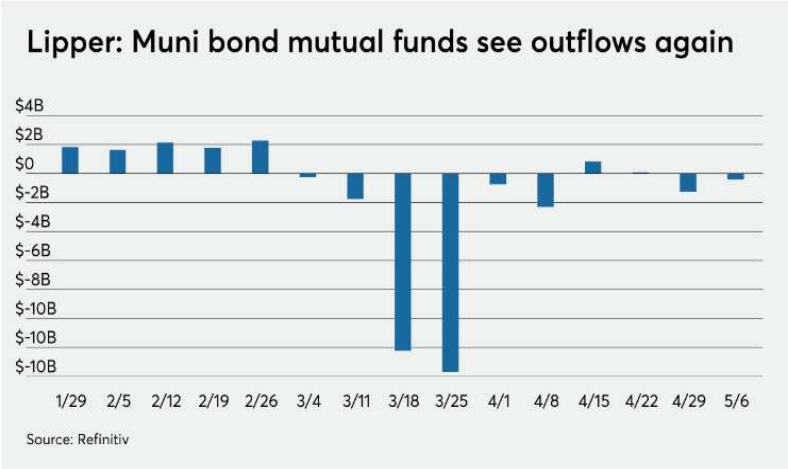
Data source: Bloomberg

Bloomberg 30-Day Visible Supply currently stands at $14.2 billion down from $14.6 billion this time last week. The YTD average visible supply is $14.8 billion and the 12-mo average is $14.0 billion.



Data source: Bloomberg

Muni Fund Flows: According to Refinitiv Lipper, muni funds had net outflows last week. Outflows amounted to $408 million after $1.3 billion of net outflows during the previous week. ETFs and high-yield funds also experienced large net outflows.



Source: Refinitiv

Articles of Interest

State Outlook Negative (Moody's): Moody's changed their outlook of the State government sector to negative from stable. They note that the downturn and recovery period will challenge states' credit strength. The highlights of the comments surrounding the downgrade include: **1)** The severe economic downturn will eventually turn into a recovery that extends beyond the reopening of business. They do not believe that state revenues will not start growing again until 2022. **2)** State actions to counter the downturn will increase financial leverage and reduce reserves. Deficit borrowing, payment delays, spending postponement and use of reserves will be key methods. Tax increases and service discontinuities, while not palatable, may also be required. **3)** Pension plan funded status will be even more pressured by both the decline in asset values and higher liabilities courtesy of the markets low interest rates. **4)** Federal aid already disbursed was aimed at reimbursing states for corona-virus related expenses and nothing yet to aid states for lost revenues. In 2009, the American Recovery and Reinvestment Act directly and explicitly supported state spending and services—about 30%–40% of state budget gaps. Moody's states that for the outlook to change back to stable would require something like a vaccine for the virus and substantial federal aid.

Local Governments Outlook Negative (Moody's): Moody's changed their outlook on the local governments sector from stable to negative. The change in outlook is based on their expectation of the length and intensity of the economic downturn causing impaired revenues and reserves. The highlights of the report include: **1)** While property taxes will decline slightly in 2020 due to moratoriums and delinquencies, the fuller impact will be a lag into 2021. Local governments that are more dependent on income and sales taxes will feel a more immediate impact. In approximately two-thirds of states primary funding is through property taxes. **2)** Fortunately, before the downturn local governments began at a five-year high for liquidity and this will better allow them mitigate distress. **3)** Local governments will likely see reductions in state aid (particularly school districts) over the next few years as they are under their own budgetary pressures. **4)** Pension plan funded status will be even more pressured by both the decline in asset values and higher liabilities courtesy of the markets low interest rates. This is will add to the already increasing proportion that fixed costs will command of revenues. Moody's says that a change in their outlook to stable will require a robust and sustained economic rebound.

Water and Sewer Outlook Stable (Moody's): Moody's issued a Sector Outlook report on municipal water and sewer utilities with a stable outlook with considerations for the impacts of coronavirus and resultant economic downturn. The highlights of the report include: **1)** most water and sewer utilities have diverse and stable customer bases which creates a base usage level, **2)** debt service coverage will generally be lower but it will be enough as generally they started with good debt service coverage levels but it will be politically less appealing raise rates **3)** liquidity is a strength of the sector with days cash on hand exceeding 500 days, **4)** the relatively good condition of infrastructure will allow for deferred capital investment.

Airports – CARES Act to Help Against Technical Defaults (Moody's): The CARES Act provides a significant amount of funding to airports to offset lost revenues due to the economic downturn due to coronavirus. Airports are finding ways to apply grant funds to allow them to apply funds to prevent technical defaults that would arise based on the definition of revenues. However, it is noted that some may not be able to find ways to avoid technical defaults. It should be noted that a technical default, which is generally something like a covenant breach, does not equate to a monetary payment default. Since airport bond investors have no access to assets and only recourse to revenue streams, the rationale for investors to accelerate technical default into monetary default lacks justification.

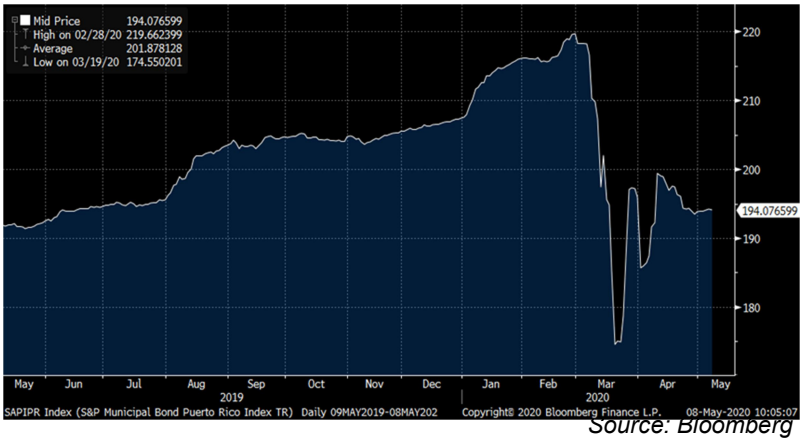
Illinois Delayed Debt Issue: The State of Illinois delayed a planned $1.2 billion short-term debt issuance to ease the revenue shortfall over the past two months of the fiscal year. However, the issuance was moved to a day-to-day status until market conditions are more favorable. Currently, the state would have paid 400 bps above benchmark yields, far exceeding any other state.

Puerto Rico

Debt Repayments in jeopardy of being cut: Puerto Rico's fiscal agency said that the debt restructuring plan may need to be revised for coronavirus economic impacts that have imparted an additional $1.5 billion cost to date. They are asking the Board to consider a change to the plan of adjustment to accommodate the new economic reality. Hearings have already been delayed by the virus.

The S&P Municipal Bond Puerto Rico Index: finished at 194.1 vs. 194.2 two weeks ago -6.4% YTD.

S&P Municipal Bond Puerto Rico Index Level (1-year)



Source: Bloomberg

Relative Value by Maturity

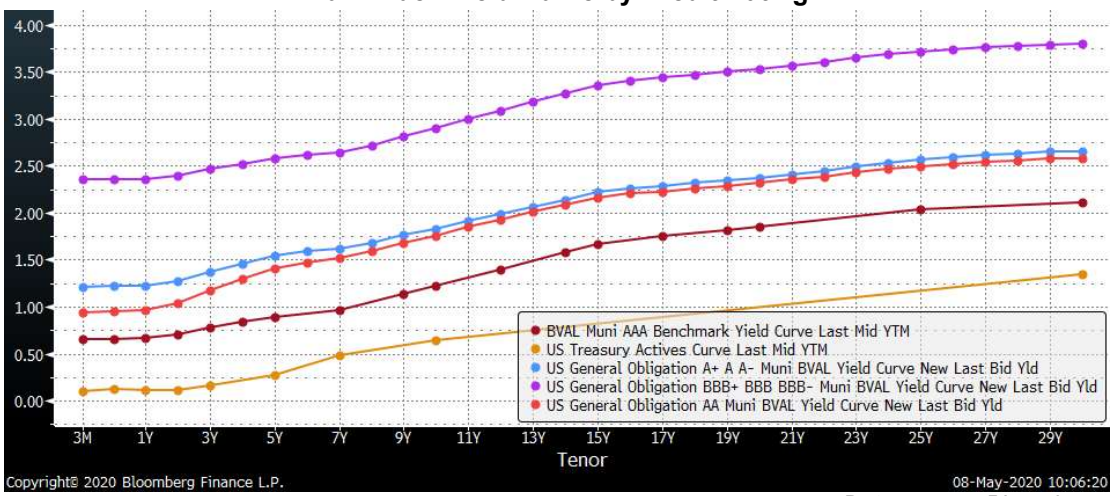
AAA Muni Ratios and Spreads by Maturity

5/8/2020	Yield-to-worst (%)		0% Tax Rate		35% Tax Equivalent	
Maturity (yrs.)	AAA Gen. Oblig.	Treasury	Spread (bps)	Ratio (%)	Spread (bps)	Ratio (%)
1	0.67	0.12	55.2	562.8	91.3	865.8
2	0.72	0.11	61.3	651.7	100.3	1002.6
3	0.79	0.17	61.9	470.5	104.2	723.8
4	0.84	0.23	61.1	367.5	106.4	565.4
5	0.91	0.28	62.1	318.2	110.9	489.6
7	0.97	0.49	47.9	198.4	99.8	305.3
10	1.23	0.64	58.4	190.7	124.4	293.4
15	1.67	0.83	84.0	200.7	174.1	308.8
20	1.85	1.06	79.2	174.8	178.8	268.9
25	2.03	1.21	82.5	168.5	191.9	259.2
30	2.12	1.35	76.4	156.5	190.4	240.8

Data source: Bloomberg

Relative Value by Rating

Muni Index Yield Curve by Credit Rating



Data source: Bloomberg

Appendix – Important Disclosures

Some of the potential risks associated with fixed income investments include call risk, reinvestment risk, default risk and inflation risk. Additionally, it is important that an investor is familiar with the inverse relationship between a bond's price and its yield. Bond prices will fall as interest rates rise and vice versa.

When considering a potential investment, investors should compare the credit qualities of available bond issues before they invest. The two most recognized rating agencies that assign credit ratings to bond issuers are Moody's Investors Service ("Moody's") and Standard & Poor's Corporation ("S&P"). Moody's lowest investment-grade rating for a bond is Baa3 and S&P's lowest investment-grade rating for a bond is BBB-. Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest).

The Bond Buyer 20-Bond Index consists of 20 general obligation bonds that mature in 20 years. The average rating of the 20 bonds is roughly equivalent to Moody's Investors Service's Aa2 rating and Standard & Poor's Corp.'s AA. The Bond Buyer 11-Bond Index uses a select group of 11 bonds in the 20-Bond Index. The average rating of the 11 bonds is roughly equivalent to Moody's Aa1 and S&P's AA-plus. The Bond Buyer Revenue Bond Index consists of 25 various revenue bonds that mature in 30 years. The average rating is roughly equivalent to Moody's A1 and S&P's A-plus. The indexes represent theoretical yields rather than actual price or yield quotations. Municipal bond traders are asked to estimate what a current-coupon bond for each issuer in the indexes would yield if the bond was sold at par value. The indexes are simple averages of the average estimated yields of the bonds, are unmanaged and a direct investment cannot be made in them.

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