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U.S. Municipal Bond Market An Issuer's Market

A Favorable Market for Issuers of Municipal Debt

A confluence of factors have gathered to begin the New Year. These factors have already morphed into what can accurately be described as a market that clearly favors municipal entities who would like to sell debt.

The Confluence of Factors – Record Flows

The leading reason is demand based: 53 straight weeks of flows into municipal funds topped out at \$2.89 billion last week, per Lipper data. Not only is 53 consecutive weeks a record, but \$2.89 billion for an individual week is also a record based on data going back about three decades. Even though municipal-to-Treasury ratios are at, or near, all-time lows, the significant amount of investment dollars flowing into municipals is causing money managers to put money to work.

Supply is just not keeping up: Average (10 year) supply for January is \$24 billion, which is tied for the lowest monthly average with February. While we expected some December 2019 issuance to spill over to this year, the supply of \$14.6 billion (\$6.5 and \$8.1 billion) for the first two weeks of 2020 has still not satisfied the market's appetite for bonds. The supply picture is even less likely to meet demand from a big picture perspective. Total annual municipal market supply has averaged \$382 billion over the last 10 years. Sure, supply jumped to \$421 billion in 2019, but \$70 billion was also taxable last year. Even if supply comes in close to our \$450 billion estimate for 2020, the issuer's market could remain if a strong amount of demand for municipals endures.

Supply and Demand Imbalance

Other influences contributing to this issuers' market are mostly investor-demand related, unsurprisingly. Global fixed income alternatives are generally unattractive with many sovereigns still offering negative rates. The 2017 Tax Cut was, and remains, a driver of municipal bond demand for individuals. The state and local tax deduction cap put into place at the end of 2017 is fueling investor demand because higher-income investors are searching for tax deductions. Nothing leads us to believe the influence from these factors will decline in the near term.

There is a limited number of municipal investment opportunities for a large and rising pool of investment dollars. The supply and demand dynamic is often the driving force in the U.S. municipal bond market. It is for now, and investor demand is a leading reason.

Tax-Exempt Municipal Yields are Near 10-Year Lows

| MMD (AAA) | Jan 14, 2020 | Date of 10 Year Low | MMD Yield on Low Date | Jan 14 Change From Low |
|-----------|--------------|---------------------|-----------------------|------------------------|
| 5 Year | 0.98% | October 10, 2012 | 0.62% | 0.36% |
| 10 Year | 1.33% | August 28, 2019 | 1.21% | 0.12% |
| 30 Year | 1.96% | August 28, 2019 | 1.83% | 0.13% |

Source: Thomson Reuters and HilltopSecurities.

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