HilltopSecurities
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U.S. Municipal Bond Market

MUNICIPAL MARKET UPDATE: COVID-19 IMPACT WORSENS

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A Coronavirus Update

The World Health Organization has officially labeled the COVID-19 outbreak as a pandemic.[1] A pandemic is more widespread than an epidemic. A pandemic is a disease that spreads across countries and continents and affects large numbers of people. It is also becoming clear that COVID-19 is spreading throughout the United States. However, a Wednesday, March 11, update from President Donald Trump, where he announced U.S. travel restrictions related to Europe, perhaps did more harm to market participant thinking than good – partially because he was not able to announce any concrete steps or stimulus plans from the federal government and also because he continued to call COVID-19 a "foreign virus." Where this is going is unknown, but it is likely for general economic activity to become more limiting. A CNN article posted Thursday, March 12, reported President Trump as saying domestic travel restrictions have not been discussed, but they are a possibility.[2]

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The number of COVID-19 cases in the U.S. has topped 1,000. Preparations at the state and local level have intensified but are uneven. Social distancing policies and activity is becoming more accepted. We continue to hear of companies canceling travel, instituting work-from-home policies, and canceling business conferences. The NBA suspended its season. The Ivy League, Big Ten, SEC, Big 12 and other conferences are canceling their basketball tournaments. Washington Governor Jay Inslee banned gatherings of 250 or more in Seattle, Washington.[3] New York state established the country's first containment zone in New Rochelle, Westchester County.[4] Globally over 100 countries have reported COVID-19 cases and the number of cases has reached over 123,000. Bloomberg News indicates there have been 4,578 global deaths reported as of March 10.[5] In comparison, the seasonal flu's mortality rate is generally well under 1.00%, per CDC estimates.[6]

General Market Considerations

We are now at the point where several economists are calling for a 100 basis point cut and potentially additional quantitative easing measures by the Federal Reserve at their March 18 meeting. In a recent analysis, Moody's Analytics Mark Zandi predicted, "The Centers for Disease Control and Prevention says it is likely that COVID-19 will become a global pandemic. If the CDC's warning comes to pass, then recession will be difficult to avoid."[7] (See HilltopSecurities' most recent economic commentary by Scott McIntyre and Greg Warner for further updates.)

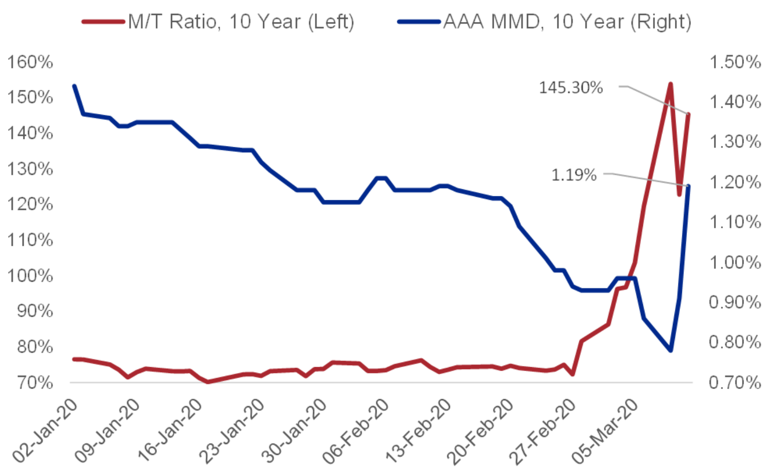
After a record 60 straight weeks of flows into municipal mutual funds, Lipper reported on March 5th that $249 million flowed out of municipal funds. This was an important signal of shifting investor demand and a key dropping off point since previously it could have been argued that municipals were being viewed as one of the sheltered asset classes.

U.S. Municipal Bond Market Review

After the Federal Reserve enacted their surprise 50 basis point cut on March 3, much has happened in municipals. After a record 60 straight weeks of flows into municipal mutual funds, Lipper reported on March 5 that $249 million flowed out of municipal funds. This was an important signal of shifting investor demand and a key dropping off point because previously it could have been argued that municipals were being viewed as one of the sheltered asset classes. After this point that was not the case. Demand for U.S. Treasuries accelerated and caused municipal-to-Treasury (M/T) ratios to rise, however this M/T environment was generally not seen as a buying opportunity. A total of about $11 billion of primary market municipal issuance was expected to price during the week of March 9, this week. But, municipal bond market demand has been unsteady at best. The issues that were being priced came at spreads wider than expected and some issues had already been postponed to begin the week.

The municipal bond market has come under significant duress in recent days – today that market movement has compounded negatively.

Chart Shows Where MMD and M/T Ratios Closed on Wed., March 11



Source: Thomson Reuters as of March 11, 2020 and HilltopSecurities.

Municipal Market Pressured Thursday March 12, 2020

The municipal bond market has come under significant duress in recent days – today that market movement has compounded negatively. Municipal Market Data (MMD) AAA yields continued their climb through Wednesday, March 11, with the 2 year closing at a 0.77%, the 10 year at 1.19% and 30 year at 1.82%. Intra-day indications on Thursday, March 12, from MMD showed that MMD yields were going to rise 33-50 basis points across the curve. This is an astounding level of movement for a one-day period in MMD. The Dow Jones Industrial average index was down by as much as 8.00% on Thursday.

The municipal market was not functioning normally today (March 12); very little pricing or trading activity occurred. Yields and M/T ratios continued to rise (as indicated) and the ability to execute negotiated pricings has come into question.

The 10 year M/T Ratio climbed to 145% at the end of March 11, and we will likely see it close even higher on Thursday, March 12. The last time M/T Ratios were close to this level was Dec. 2011 when it hit 123% and Dec. 2008 when it peaked at 186%. And while M/T ratios continued to rise, the movement was still generally not considered a buying opportunity. There is still too much uncertainty among the investor community at this point. Also on Thursday, Lipper reported investors withdrew $1.76 billion from municipal mutual funds. This follows last week, which saw investors pull out $250 million from municipal funds. This activity, especially if it continues, only serves to complicate the municipal investor landscape.

The municipal market was not functioning normally today (March 12); very little pricing or trading activity occurred. Yields and M/T ratios continued to rise (as indicated) and the ability to execute negotiated pricings has come into question. Some issues were priced at the beginning of the week, but now the ability for the market to be accessed remains questionable. Price discovery remains a key challenge now as investors have backed off most likely because of the uncertainty they face. Many issues that were set to price on a negotiated basis have been postponed. Only a very limited number of issues were bid competitively, and those only received a very small amount of participation. Secondary market trading can only be described as minimal.

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It would be presumptuous to assume this uncertainty is going to clear up in a matter of hours or even days. There certainly could be some moments where we see a limited amount of investor interest, but exactly when and at what level is a mystery. How long this environment lasts and how much worse it becomes is currently unknown. We are still likely in the very early stages of what can be described as the financial impact from the COVID-19 effect.

Recent HilltopSecurities COVID-19 Municipal Commentary

- Lowered Airport Sector Outlook: Recent COVID-19 Impact, March 11, 2020
- Falling Confidence and No Federal Stimulus Increase to Start the Week, March 9, 2020
- Uncertainty – What the Municipal Market Knows and Doesn't Know About COVID-19, March 4, 2020
- Bracing for the Worst; the Coronavirus Market Effect – Status of the Coronavirus Impact on the US Municipal Bond Market (page 2); Feb 26, 2020.

Recent HilltopSecurities COVID-19 Economic Commentary

- Central Banks Rush to Mitigate Pandemic Fallout, March 11, 2020
- Untying the Knot, March 10, 2020
- Runaway Markets Ignore Massive Payroll Number, March 6, 2020.
- Bracing for Zero, March 5, 2020

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[1] Coronavirus confirmed as pandemic by World Health Organization; March 11, 2020.
[2] Trump says domestic travel restrictions haven't been discussed but are a "possibility"; CNN; March 12, 2020.
[3] Gov. Inslee to ban gatherings, events of more than 250 in Seattle amid coronavirus outbreak, AP Reports; KIRO7, Associated Press; March 10, 2020.
[4] Soucheray, Stephanie; First US COVID-19 containment zone in NY, 51 more cases in Massachusetts; University of Minnesota Center for Infectious Disease Research and Policy; March 10, 2020.
[5] U.S. Cases Top 1,000; Containment Efforts Boosted: Virus Update; Bloomberg News; March 10, 2020.
[6] Zandi, Mark; COVID-9 Pandemic Scenario: Known Unknowns; Moody's Analytics; March 2020.