

January 2021

MUNIWATCH

FIXED INCOME MARKET UPDATE



As we begin 2021 and (finally) put an end to 2020, we would like to thank you for your continued support. We hope you and your family had a happy and healthy holiday season.

Munis were virtually unchanged in December, outperforming U.S. Treasuries, which sold off by 7-10 basis points (bps) across the curve. Market activity was subdued as issuance slowed in December but full-year issuance broke the record for highest ever. Credit spreads continued their dramatic narrowing as more government support is expected, especially with the likelihood of a Democratic Senate. So-called “problem” credits, such as the New York City MTA (which we’ve added to our spread tracking list on page 3), have seen the most significant narrowing. We continue to focus on high grade credits as underlying economic risks still exist and rates remain at historic lows, leading to limited upside potential.

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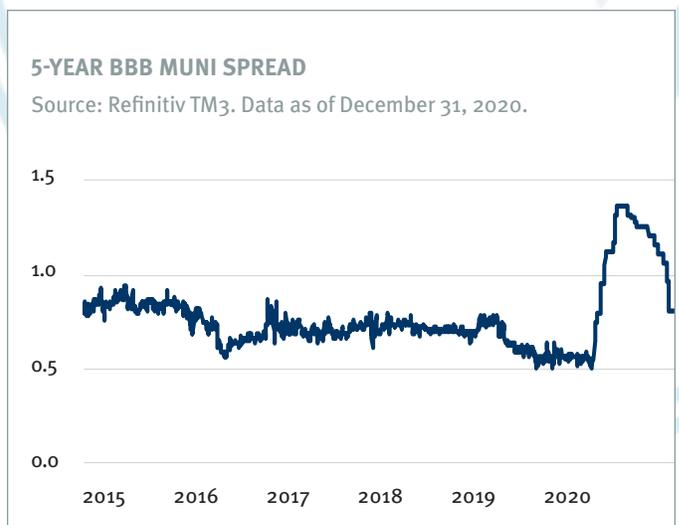
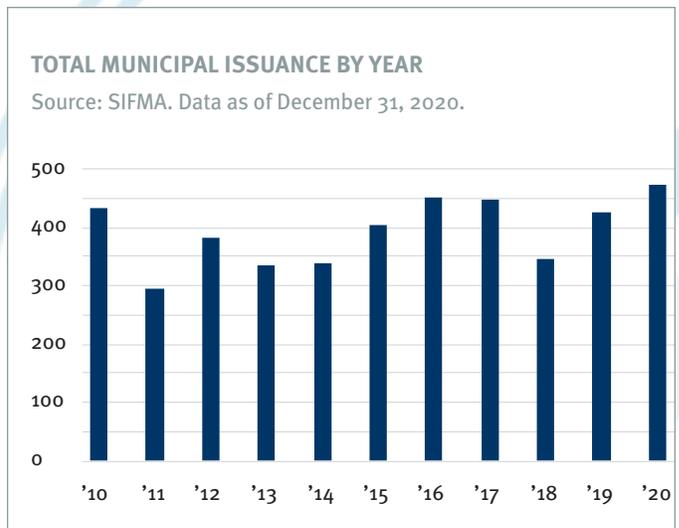
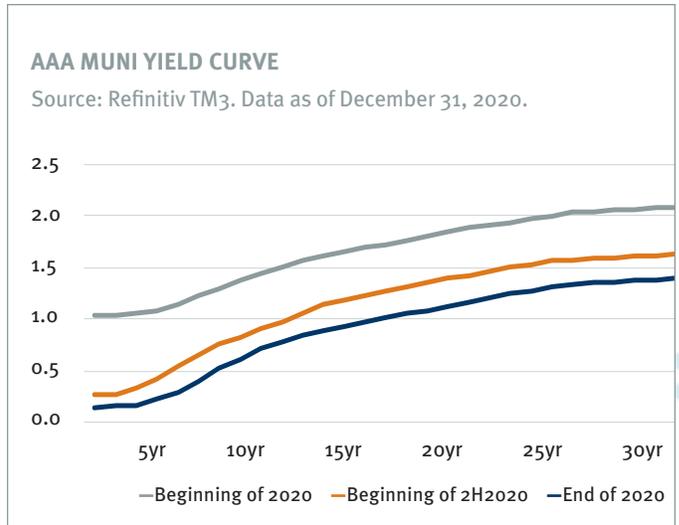


Muni Yields Flat in December, Record 2020 Issuance

Muni yields declined by 1-2 bps in December while Treasury yields rose by 7-10 bps. The yield curve shifted lower by 70-90 bps for the full year (graph, top-right), following the Federal Reserve’s (Fed) shift to an accommodative stance as a result of the pandemic. Issuers took advantage of these low rates, mainly to refinance existing debt, and issuance ended the year at \$473 billion, breaking the previous record of \$452 billion in 2016 (graph, middle-right). Even as yields have fallen dramatically, Muni mutual funds saw inflows of \$6.6 billion in December and virtually every week since the market dislocation in March, totaling \$61.6 billion.

Credit Spreads Narrow

Credit spreads have narrowed by over 50 bps from their peak in July (graph, lower-right) as the prospect of increased government support becomes more likely, not due to any significant improvement in credit quality. Spreads on “problem” issuers have narrowed even more dramatically; the New York City MTA by over 160 bps and the State of Illinois by nearly 100 bps in the fourth quarter, according to Bloomberg. While the prospect of a Democratic Senate increases the chance of additional government support, we continue to emphasize careful sector and individual credit selection with low yields leading to limited upside potential.



STATE OF THE STATES



Highlights

NYC MTA: Spreads narrowed by over 160 bps in the fourth quarter (though trading was light) due to the increasing probability of government support, not improving credit fundamentals. The MTA borrowed \$2.9 billion from the Fed in December as well as \$450 million in August, which led to a deficit-financed 2020 budget surplus. The Agency anticipates an additional \$4.5 billion in aid this year, which will cover its projected 2021 deficit, but still leaves deficits of at least \$3.1 billion in each 2022, 2023, and 2024.

Illinois: Similar to NYC MTA, spreads narrowed by nearly 100 bps in the fourth quarter in light trading as increased government support becomes more likely, not improvements to credit quality. The State borrowed \$2 billion from the Fed in December in addition to the \$1.2 billion borrowed in June to address a projected \$3.9 billion deficit in 2021. However, the State's projected deficits balloon to over \$4.7 billion in each 2022, 2023 and 2024.

* Proxy Issuer used.

States with insufficient GO debt or lack of Proxy Issuer: MO, AL, IA, AR, NM, WV, AK, ME, ND, ID, SD, MT, VT, WY

STATE GO 10YR YIELD AND SPREAD TO AAA

Spread widening noted as (+), spread narrowing noted as (-)

Source: Bloomberg. Data as of December 31, 2020.

| State | Yield on 10yr Maturity (%) | Current Spread to 10yr AAA Muni (bps) | 3-Mo Change in Spread (bps) | YTD Change in Spread (bps) |
|---------|----------------------------|---------------------------------------|-----------------------------|----------------------------|
| CA | 0.80 | 13 | -17 | +9 |
| NY | 0.72 | 5 | -11 | +9 |
| NYC MTA | 2.26 | 159 | -166 | +124 |
| TX | 0.69 | 2 | -14 | -10 |
| IL | 2.53 | 186 | -97 | +57 |
| FL | 0.74 | 7 | -3 | -2 |
| PA | 0.94 | 27 | -4 | -2 |
| NJ | 1.50 | 83 | +8 | +33 |
| OH | 0.79 | 11 | +3 | -1 |
| MA | 0.76 | 8 | -9 | +2 |
| WA | 0.80 | 13 | +3 | -1 |
| MI | 0.77 | 10 | -10 | +2 |
| CO* | 0.76 | 8 | -0 | +3 |
| VA | 0.73 | 5 | +2 | +3 |
| GA | 0.70 | 3 | -5 | +2 |
| MD | 0.76 | 9 | +0 | +1 |
| WI | 0.85 | 18 | +14 | +9 |
| MN | 0.73 | 6 | -1 | -0 |
| AZ* | 0.83 | 16 | +3 | -2 |
| CT | 1.07 | 39 | -9 | -7 |
| NC | 0.74 | 7 | +9 | +5 |
| OR | 0.69 | 2 | -9 | -8 |
| IN* | 0.86 | 18 | -1 | +8 |
| TN | 0.66 | -1 | -10 | -1 |
| SC | 0.71 | 4 | -1 | -1 |
| LA | 0.95 | 28 | +2 | +11 |
| KY* | 0.96 | 29 | +1 | +3 |
| DC | 0.75 | 8 | +5 | -5 |
| NV | 0.99 | 32 | +7 | +13 |
| UT | 0.70 | 3 | -5 | -5 |
| KS* | 0.92 | 25 | -12 | +15 |
| NE* | 0.84 | 17 | -19 | +10 |
| OK* | 0.84 | 17 | +2 | +4 |
| HI | 0.80 | 13 | -14 | -0 |
| MS | 0.82 | 15 | +1 | -1 |
| AR* | 0.98 | 31 | -10 | +12 |
| RI | 0.78 | 11 | -6 | -13 |
| DE | 0.72 | 5 | +2 | +5 |
| NH | 0.75 | 8 | 4 | 2 |

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