

MUNIWATCH

FIXED INCOME MARKET UPDATE



After rising in October, Muni yields fell dramatically in November, outperforming yields on U.S. Treasuries. Munis rallied with Treasuries after the election results were announced but did not track the selloff in Treasuries after successful COVID vaccine trials were revealed. Issuance slowed in November to only about \$20 billion, causing a renewed supply and demand imbalance, a dramatic shift after October's issuance broke monthly records and pushed total 2020 issuance to a yearly record. Even with yields resetting lower, Muni mutual funds continued their streak of inflows, taking in another \$6 billion in cash. Credit spreads continued to fall as economic conditions improved and the market continued to search for yield in this low-rate environment. We believe credit risks remain high, especially with the recent resurgence in cases, but these technical factors have driven the outperformance in Munis.

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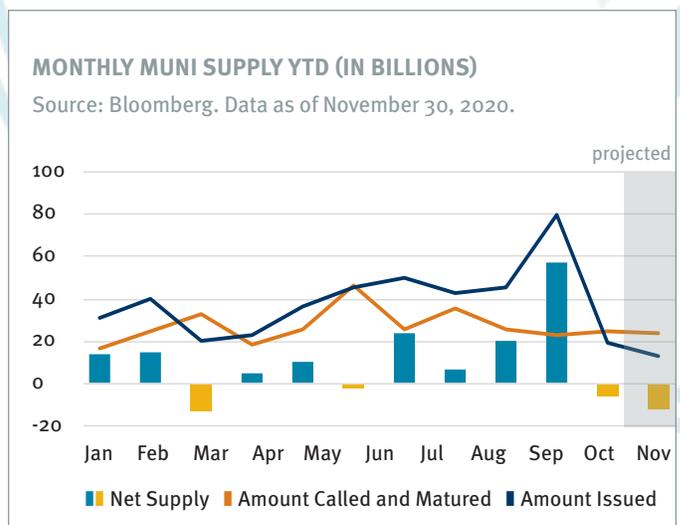
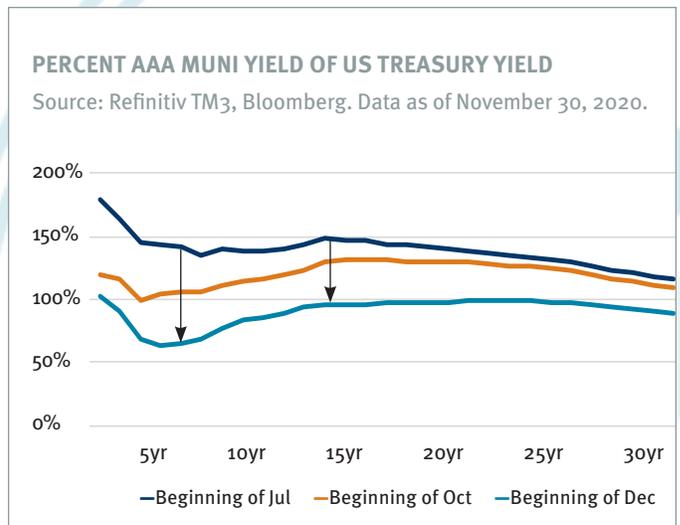
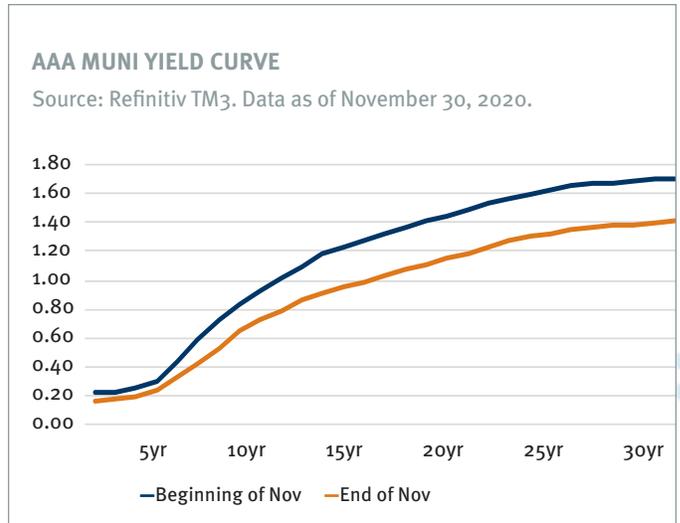


Muni Yields Fall, Outperform Treasuries

Muni yields declined by up to 30 basis points (bps) in November, with the long end outperforming (first graph, right). The market rallied in concert with Treasuries after election results pointed to a split legislature but, while Treasury yields rose after the announcement of successful Covid vaccine trials, Muni yields held their lower levels. The Muni to Treasury Ratio has returned to a more normal level, with virtually the entire curve moving below 100% (second graph, right).

Negative Net Supply Spurs Rally

As expected, the lack of issuance in November caused a renewed supply and demand imbalance as cash from calls and maturities combined with mutual fund inflows chased a limited amount of bonds available to buy, a classic case of “more buyers than sellers.” While new issuance was higher than anticipated, negative net supply reached \$5 billion, the highest since the market dislocation in March. This negative net supply will continue in December as the amount from calls and maturities outpaces expected issuance by \$11 billion (third graph, right). Credit spreads have now narrowed by over 30 bps from their peak in July (fourth graph, right). With low yields leading to limited upside potential, we continue to emphasize careful sector and individual credit selection.



STATE OF THE STATES



Highlights

Since starting the year at historic lows, credit spreads hit extreme highs during the pandemic-driven market dislocation in March and April, and have since returned to more normal levels. Seemingly all Muni credits have experienced spread widening year-to-date but States who entered the crisis with strong fiscal management have been able to so far make their way through.

New York: New York has proven its economic diversity and has continued to surprise to the upside since the depths of the pandemic. As of September, YTD tax receipts are down only 2.6% from the same period in 2019. The State's economy, driven in large part by New York City, was hit hard during the first wave of shutdowns. Since then, economic conditions across the State have improved and spreads have narrowed dramatically over the past three months.

Illinois: Illinois announced last week that it intends to borrow an additional \$2 billion from the Federal Reserve's (Fed) Municipal Liquidity Facility to address its liquidity crunch. The State already borrowed \$1.2 billion from the Fed earlier this year. We expect spreads to remain high as the market weighs the State's strained finances and the potential for a rating downgrade to sub-investment grade.

New Jersey: As expected, New Jersey's \$3 billion new issue last month received strong demand, reporting over \$38 billion in orders. The deal was priced attractively at wider spreads than secondary market trades, causing its spread to widen slightly from our previous report. We expect spreads to narrow over the next few months as the State's economic conditions improve.

* 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

(In Order of Outstanding GO Debt)

Source: Bloomberg. Data as of November 30, 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	0.86	16	+1	+12
NY	0.76	6	-35	+11
TX	0.71	1	-12	-11
IL	3.51	281	+56	+152
FL	0.76	6	-5	-3
PA	0.99	29	-4	0
NJ	1.68	98	+4	+48
OH	0.75	5	-7	-7
MA	0.81	11	-4	+5
WA	0.81	12	-11	-3
MI	0.80	10	-15	+2
CO*	0.77	7	-6	+2
VA	0.68	-2	-3	-5
GA	0.74	4	-6	+3
MD	0.75	5	-5	-3
WI	0.82	12	+6	+2
MN	0.72	2	-6	-4
AZ*	0.83	13	-3	-5
CT	1.10	40	-11	-6
NC	0.73	4	+6	+2
MO	—	0	0	0
OR	0.71	2	-9	-8
IN*	0.85	15	-2	+4
TN	0.77	8	+1	+8
SC	0.75	5	-6	+1
AL	—	0	0	0
LA	0.94	25	-3	+7
KY*	1.02	32	-2	+6
DC	0.77	7	0	-6
NV	1.03	33	+14	+14
UT	0.72	2	-5	-6
KS*	0.92	22	+2	+12
NE*	0.83	13	-3	+6
OK*	0.88	18	+5	+6
HI	0.98	28	+2	+15
IA	—	0	0	0
MS	0.84	14	-3	-2
AR*	1.01	31	-9	+12
NM	—	0	0	0
RI	0.82	12	-5	-12
WV	—	0	0	0
AK	—	0	0	0
ME	—	0	0	0
DE	0.72	2	-3	+2
NH	0.81	12	+6	+5

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