A.H. Williams

Spinnaker Report

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AHW &Co Quarterly Commentary
January 2018

It feels like December 1985 again! (I wish my body felt the same.) That was the month that municipalities rushed to beat changes in tax law, bringing over $50 billion in new deals. December 2017 will probably not beat that record, but it could come close, as municipal finance bankers make a dash to their municipal clients, advising them to beat a perceived year-end deadline to issue bonds that may be disallowed in 2018.

Volatility has returned as a result, and this has driven a substantial, if short-lived, change in our strategy. From a record level of defensiveness in November, we moved quickly to a moderately aggressive position by mid-December. The competition for product went from nothing one day to huge the next. It is impossible to pick tops or bottoms, akin to catching a falling knife so we scaled our purchases and entry levels. We are happy with our position as it stands, and have witnessed significant demand as the supply bubble recedes. Our strategy is to sell into strength and we expect that early 2018 will see increased demand for the bonds we own.

Generally, there is a negative correlation with fixed income securities and equities. They tend to move in opposite directions since good economic news is positive for stocks and negative news favors bonds. 2017 was a year that saw both asset classes perform positively. We continue to watch closely the US Treasury market for signs of the Federal Reserve tightening cycle, which has so far produced a flattening yield curve, with longer term bonds holding support levels and short term securities seeing yields rise. Tax law changes will produce a higher deficit that will require more issuance of US Treasury securities that may put pressure on buyers to absorb this supply.

Now that 2017 is in the record books we can see that our strategy of being cautious but opportunistic when the odds are in our favor has proven valuable. There were 4 major moves in the municipal bond market in 2017 and our active management strategy performed extremely well producing enhanced monthly returns during these periods. While never perfect this translates into an advantage from a risk/reward standpoint. We remain vigilant in adhering to our methodology of providing value added investment management services to our clients. Thank you for your ongoing support.

Death-Race Bondathon in Muni Land Sparked by Tax Reform Talks

2017-11-24 12:00:05.0 GMT

By Joe Mysak

(Bloomberg) -- Welcome to the most exciting post- Thanksgiving for Muni Land since the rush-to-market record set in December of 1985. The forward calendar grows by the billion every day.

What set all this in motion is tax reform, or at least the threat of it.

- Under the House version, the tax-exempt financing of stadiums, tax credit bonds, advance refundings and tax-exempt private activity bonds would all be eliminated. Under the Senate plan, only advance refundings would go. Next week, the two sides sit down to reconcile their versions.

- The process was described by my colleagues Erik Wasson and Sahil Kapur earlier this week. I took special note of one particular sentence in their story: "The GOP's narrow, two-vote majority in the Senate means that if the chamber's leaders can put together enough votes to pass a bill, the final legislation will probably look a lot like their version." Which means to me: Goodbye advance refundings. Bloomberg Intelligence's Eric Kazatsky in a blast email earlier this week said his sources tell him that Senate Republicans don't want to compromise on this issue. "They feel like they did the industry a solid by protecting the underlying exemption, and by preserving private activity bonds," Kazatsky wrote. Still, among the options being discussed, according to Kazatsky, are retaining advance refundings but limiting them to small issuers, meaning those who borrow less than $50 million a year; retaining advance refundings but restricting investment of proceeds; and eliminating advance refundings but expanding current refundings from 90 days to 365 days before the call date. Nobody is taking chances, though, nor should they. As day chases day, the calendar fills with the at-risk advance refundings and private activity bond issues.

- The story bond segment of the market was just beginning to flourish again, too, with financings for Elvis Presley's Graceland, the Queen Mary, high-speed rail. Oh, the deals we'll see in the next 30 days!

Municipals Cheapest to Treasuries Since May as Supply Builds

2017-11-24 16:14:48.41 GMT

By Christopher Maloney

(Bloomberg) -- The 10-year municipal bond benchmark is at its cheapest level versus U.S. Treasuries since May as the supply calendar builds, with issuers looking to get ahead of potential changes to the tax code.

* BVAL 10-year AAA index yields more than 90% of U.S. Treasury counterpart, the highest since May 19, according to data compiled by Bloomberg

* As of Wednesday, 30-day visible supply was $19.5b, largest since Oct. 2016

* While some analysts expect more supply for the full year than previously forecast, last year’s record issuance still appears out of reach

Muni Market Bond Famine May Magnify January Effect on Returns

2017-12-11 20:48:55.328 GMT

By Christopher Maloney

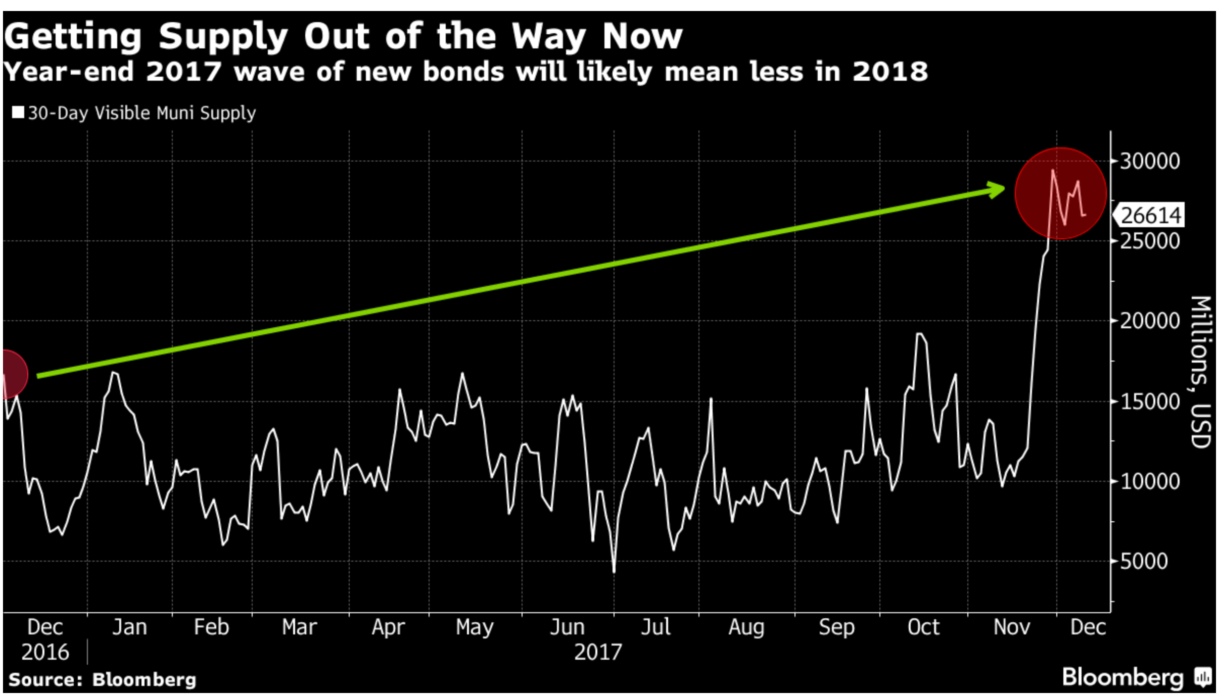
(Bloomberg) -- The muni market has seen robust returns so far this month despite the bond issuance deluge. January is seasonally a good one for muni bulls, who look set for bumper gains magnified by a New Year supply famine.

- * The first calendar month has seen the best average monthly return of the year, at 1.37% over the past decade. Second is April, with 1.15%, according to Bank of America Merrill Lynch index data

- ** Four of the top monthly returns over the last decade have occurred in January, the most of any month. There has been just one year (2011) of the past 10 when the sector sold off in January

- * December return for Bloomberg Barclays Municipal Bond Index month-to-date 1.09%

- * About $40b in supply has been pulled forward into late 2017 from next year, according to PNC municipal strategist Tom Kozlik



Reprinted from Bloomberg

Market Likely to Continue to Shrink in 2018

By Joe Mysak

This is the time of year when analysts are looking ahead and making forecasts about how much states and municipalities will raise by selling bonds in 2018. I'll take a different tack. Here's what you won't have next year.

- For starters, you won't have at least $282.2 billion of bonds that will disappear once they mature, and that only counts January through November. The top month for maturing bonds, so far, is August's $41.2 billion, and that follows June $38.6 billion and July's $39.1 billion.

- We don't have data on announced calls yet, but in 2017, they averaged $11.7 billion per month. Most municipal bonds are callable in 10 years, so you look back a decade to get a feel for calls. Issuance in 2008 was down from 2007, but not by a lot, so let's round down to a projected average of $11 billion a month. That's $132 billion.

- So between bonds maturing and being called, we could be talking about at least $414.2 billion that will be looking for a new home, presumably back in the municipal market.

- And, thanks to the tax legislation in Congress that is promising to yank the subsidies from many deals, the tax-exempt market looks like it will be significantly smaller. Most of the forecasts I've seen for 2018 are for new sales to decline, from what looks like over $400 billion this year to anywhere from $300 billion to $350 billion, which means that the total size of the municipal market is very likely to shrink again in 2018.

- To put this in context, long-term volume stands at $374 billion so far this year, while $439.7 billion in bonds have matured or been called.

- In 2018, the municipal market may be characterized by two words: scarcity value. The "January effect," where lo

Dwindling Supply Could Lead to a Super January Effect: Joe Mysak

2017-12-14 19:57:42.300 GMT

By Danielle Moran

(Bloomberg) -- The municipal market is in a supply frenzy this month as issuers rush to market in anticipation of the passage of a federal tax overhaul and volatility has returned as the 10-year benchmark yield responds to the flood. Joe Mysak, editor of the Bloomberg Brief Municipal Market newsletter, answered questions about tax reform legislation and its potential impact on the sector during a TOPLive Q&A on Thursday.

- Q: How do you expect the whiplash of tax reform (especially with regard to private activity bonds) to impact supply in early 2018?

- A: For sure, the first quarter will be very light, because so much has been rushed into 2017. Over all, we're probably talking about a year in the $300 billion, low $300 billion range, if we have no advance refundings but keep PABs. What will really throw people is if Congress in its wisdom has decided to differentiate between different kinds of PABs. The lawyers will be going crazy.

- Q: Where do we stand with tax reform? Just in the last hour, House Ways and Means Chairman Kevin Brady said taxpayers will be able to deduct state income taxes or state sales taxes in addition to property levies -- up to a $10,000 cap. Does that make a difference to the MuniLand when it comes to SALT?

- A: Every little bit has got to help the high-tax states cope with tax reform. But, I almost don't believe any of these sweeteners/tinkerings until I see it in final print form. It's going to be a long weekend, because you have to go through every page. The sort of manic hysteria attached to getting this thing passed isn't very helpful. I really think we (they) will revisit tax reform in 2018 or 2019.

- Q: Joe, with your long experience in the muni market, is this the closest we've been to tax-exemption possibly going away (at least for part of the market)?

- A:That's a good one. There have been lots of false alarms/various reports over the years; but yes. What I found profoundly unhelpful in all of this was a headline that appeared in September after the framework was announced, saying, 'Exemption Safe.' And then on Nov. 2 we learn that, well, yes, part of the exemption is safe, but about 40 percent of the market isn't. I have to think that with a little more time, the market's lobbyists and issuers might have been able to make more a defense.

- Q: If the final tax bill does remove advance refundings, do you think municipal issuers will begin to re-think the typical muni new issue structure that has 10 years of call protection?

- Do you think muni issuers will look to shorter non-call windows like 5 years or shorter to preserve their ability to refund bonds using a current refunding transaction?

- A: Oh yes! Excellent observation. I was at a party last week, the Municipal Bond Club of New York's holiday party, and at least three people brought this up. Five-year calls will become a thing. I have to think buyers will put up some resistance; but maybe not, in a rising-rate environment. Maybe they'll welcome shorter calls. Bond buyers in the early 1980s probably would have welcomed shorter calls.

- Q: For the coastal states, a $10,000 SALT deduction cap still hands a larger tax bill to most higher income California residents, thus creating more demand for the same double tax- exempt coupon in 2018. Your thoughts?

- A: Demand is going to ramp up in the high-tax states, of course. Even nationally it looks like tax-exempt munis will be one of the last tax shelters out there, so that, too, will heighten demand. And states and municipalities don't really sell to meet demand. They sell when they need to. And then there's the little matter of bonds maturing/calls and redemptions. In 2018, this amounts to more than $414 billion looking for a new home, presumably back in the tax-exempt market. As CJ Maloney here pointed out, it's like a Super-January Effect.

As Muni Market Whipsawed by Tax Uncertainty, Volatility Returns

2017-12-12 18:35:19.461 GMT

By Elizabeth Campbell

(Bloomberg) -- For investors in the municipal-bond market, December's been a bumpy ride. The price swings in the 30-year municipal benchmark have been the largest since the end of last year, when investors were speculating that President Donald Trump's victory meant the Federal Reserve would more aggressively raise interest rates.

The cause this time is again coming from Washington, with provisions in the proposed tax-code overhaul threatening to sharply reduce sales of tax-exempt bonds beginning in January. The legislation has pulled investors between two poles. On the one hand, they're digesting a potentially record-setting wave of new sales as issuers rush to market before the end of this month -- which has put downward pressure on prices some days. On the other, they're looking ahead to next year, when a scarcity of tax-exempt bonds may make them more valuable.

But tight now, it's hard to say how much the municipal market will shrink next year because Senate and House negotiators are still working on their final version of the bill.

- "Massive volumes and equally aggressive demand are driving strong volatility," Matt Fabian, a partner with Municipal Market Analytics, said in an e-mailed report on Tuesday.

- Until Dec. 6, those playing the long game were in charge, sending the yield on the 30-year benchmark down by 0.35 percentage point to 2.56 percent, its biggest five-day drop since 2011. Then the pendulum swung the other way, pushing the yield back to 2.75 percent by Tuesday.

- That volatility is expected to calm down in 2018, said Adam Buchanan, senior vice president of municipal sales and trading at Ziegler Capital Markets Group in Chicago. January typically sees a supply slowdown, and that would be "amplified" if the tax-code changes for munis become law.

- "I think you would see a strong market," Buchanan said.

- "You'd see a strong bid for whatever tax-exempt product was available in the marketplace."

Morgan Stanley Says 2018 Net Muni Supply Will be Negative $8B

2017-11-28 19:58:50.741 GMT

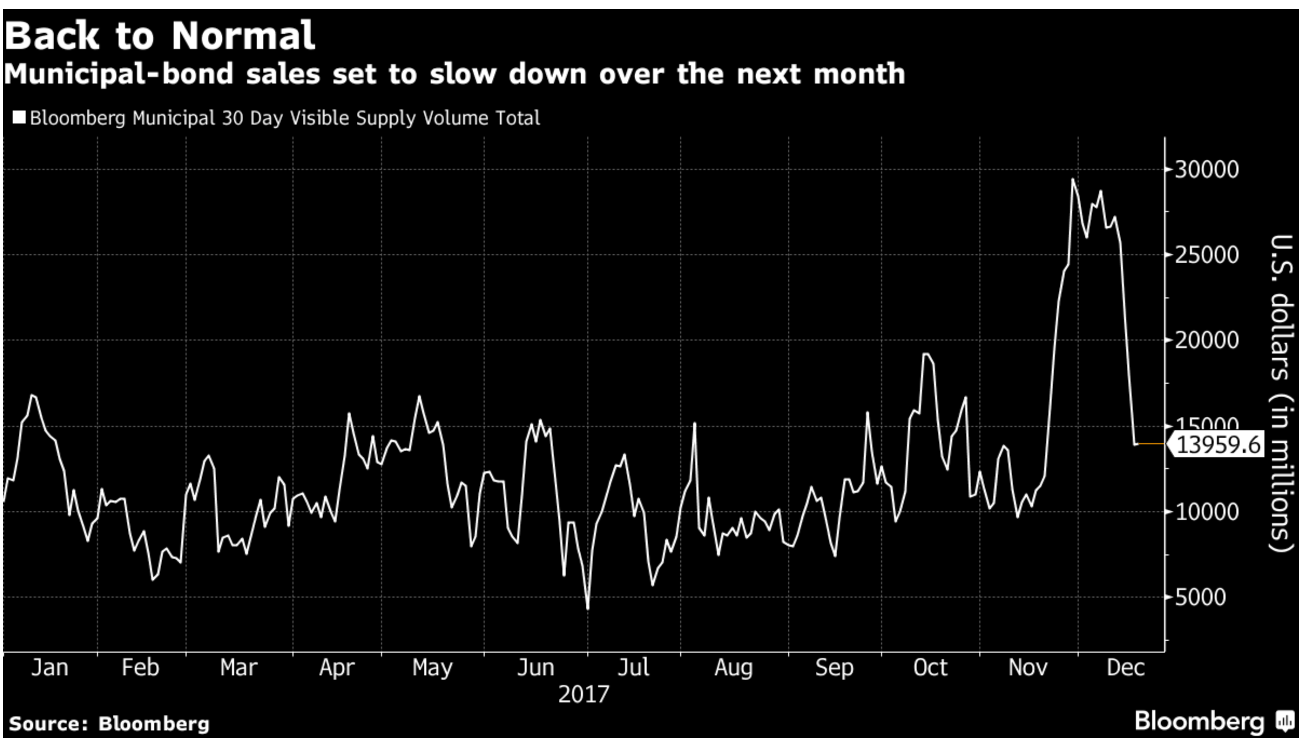
By Danielle Moran

(Bloomberg) -- Next year may see municipal gross supply of

$335 billion and net supply of negative $8 billion, according to Morgan Stanley municipal strategist team led by Michael Zezas.

- * This base case scenario foresees $270 billion in new money issuance and $65 billion in refundings; final total will depend on how much issuance is pulled forward to get ahead of the proposed tax reform legislation and that legislation’s final outcome
- ** The decrease includes a $100 billion reduction in advanced refunding bonds, a refinancing feature that would be repealed in both the House and Senate proposals
- * New money issuance will be driven by greater issuer confidence due to economic growth and their experience of relatively cheap tax-exempt financing in 2017
- * Net supply YTD is about $39 billion, was $44 billion and $16 billion in 2016, 2015
- * There is a "wider variance in supply outcomes than normal" as net supply could be $116 billion over the base case given a strong rates rally and no advance refunding repeal or $30 billion below if rates sell off and both private activity bonds and advanced refundings are repealed
- * Expect duration and coupon as a more dependable driver of performance than spread compression next year
- ** Recommend starting year with duration overweight, adding 20+ year maturities
- ** Recommend high-quality utility, higher education and transportation sectors. Underweight state and local general obligation bonds
- * Municipals should fare well in the future environment, "given its potential as a late cycle haven"

Supply plunge



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