Spinnaker Report

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AHW &Co Quarterly Commentary April 2018

Very rarely do fundamentals and market sentiment line up in the form that they did in December. Because the tax bill of 2017 disallowed a large portion of new municipal bond issuance, namely refundings, or refinancings, most of the issuance of Q1 2018 was moved up to last December. This resulted in a December 2017 with over $65 billion of issuance of new bonds, which set a new record. Both retail and institutional investors gobbled up the new supply in the belief that January would bring a dearth of offerings. We aggressively participated and received relatively instant gratification and believed this strategy would continue and produce an enhanced January effect, where 80% of the time prices rise during this important reinvestment period.

As January dawned, it became apparent that this strategy was being suppressed by tax law changes that affected the incentive for some institutional clients, mainly insurance companies, to hold tax exempt bonds making them net sellers of municipals. The additional federal deficit produced supply concerns in the US Treasury market, which saw rates rise. Economic data were stronger than expected, which led to a more hawkish tone from the Federal Reserve just as the new Chairman took office. As soon as we began to feel headwinds develop we quickly reversed course, and sold the bulk of what we had purchased during the December supply bulge, bringing our clients' leverage down to near-record lows.

Year to date performance is quite the opposite of what we envisioned with most of the negatives resulting in price erosion from the last days of December to early January. Sometimes the best offense is a good defense and we are adhering to that strategy by weighing risk vs. reward and preferring only to make commitments when conditions favor. It is impossible to predict the future and when the trend may shift. Most recently the equity market has become very volatile and bonds have received some risk-off rallies. Many expected the UST 10 yr yield at 3% by now. It did come close but quickly rebounded back to a 2.75% on trade war fears. We still believe that munis are a good value in comparison with other fixed income assets as they presently yield more than their taxable counterparts in many places on the yield curve. We continue to scour the market for value. We expect continued headwinds and remain very cautious especially heading into tax season. New issuance remains low, and May, June and July are typically strong reinvestment periods. Rising rates hinder short term performance but in the long run are a blessing in disguise since they recalibrate the market and permit patient investors valuable entry points. Enclosed in this newsletter are the most recent Morningstar rankings. These point out what we have always expressed as our "value proposition" and we are proud to rank so highly against such a diverse and vast cross section of peer group competitors.

As always we remain vigilant and seek to provide our clients with extraordinary service and bond management services.

When Will We Learn Not to Bet Against Bonds?: The Daily Prophet

2018-03-27 20:30:12.279 GMT

By Robert Burgess

(Bloomberg Prophets) -- A lot of very smart investors have looked very dumb in recent years by predicting a bear market in bonds. Of course, bonds have had their ups and downs, but nothing that can really be called a full-on, nasty, 1970s-style selloff. And while they may still turn out to be right, it's probably not going to happen this week.

More than a few bond traders were on edge coming into Monday as the U.S. Treasury prepared to embark on an unprecedented spurt of borrowing to finance a growing budget deficit. In all, the government will end up selling about $300 billion of Treasury bills and notes in this holiday-shortened week. That's more than the government bond markets of Portugal, Ireland and Sweden, to name just a few. So, how are things going at the halfway mark?

Better than many probably expected. The market digested $126 billion of three-month, six-month and two-year debt on Monday without too much disruption. The same goes for Tuesday's sales of $124 billion in four-week, 12-month and five-year debt.

Perhaps most telling is that the five-year note auction drew the most bids relative to the amount sold for that maturity since September, which is a sign of strong demand.

The so-called bid-to-cover ratio for the five-year note auction jumped to 2.50 from 2.44 last month. There's more to come.

Investors on Wednesday will bid on $15 billion of 2-year floating-rate notes and $29 billion for seven-year notes. Of course, the recent wobble in stocks and the concerns about a budding trade war between the U.S. and China have helped to bolster demand for haven assets such as Treasuries, but that hasn't stopped strategists from putting out with reports on Treasuries with suggesting bonds may be on the cusp of a bullish breakout.

(BN) Muni Analysts Have Brighter Outlook After Worst Start Since 1996

By Danielle Moran and Elizabeth Campbell

(Bloomberg) -- The municipal-bond market started the year off terribly by posting the biggest first-quarter loss in more than two decades, largely because of the January selloff triggered by concern the Federal Reserve would raise interest rates more aggressively than previously expected. But with the market having since stabilized -- and even gaining slightly on Monday, the first day of the new quarter -- some analysts think the worst may be over.

Here's what analysts from municipal-bond underwriters expect ahead.

Phil Fischer and Yingchen Li, Bank of America Corp.

Fischer, head of municipal research for the largest underwriter, said he and his colleagues are "much more constructive" on the market now.

"We think the muni market is going to rally a lot more from here," Li, a muni strategist, said in a telephone interview. "It's really about the Fed. We don't expect the Fed to hike two more times, if Libor curve is any guide." Li said that curve is almost entirely flat, and when that happened in 2006, the Fed stopped tightening monetary policy.

Vikram Rai, Head of Municipal Strategy at Citigroup Inc.

Rai began the year with a bullish stance, anticipating that the drop off in debt sales and steady demand from investors would be good for returns. The market was whipsawed early in the year by concerns about rate hikes and diminished demand from some corporate buyers. Sales of bonds that were scooped up during December's flood of issuance also exerted a drag. He said supply and demand patterns -- and the high yields on munis relative to Treasuries, or ratios -- makes them attractive. "Given the technicals are positive and muni ratios are attractive, we expect munis to do well, especially as we enter the summer months," he said. "Munis should do especially well because that is where we see negative net-issuance."

Rai said 10-year bonds have the most room to outperform because there is solid demand for debt of that maturity. He said they have "less conviction" on the 30-year because the market is very dependent on demand from corporations who aren't buying like they used to now that their tax rate has been dropped.

Mikhail Foux, Head of Municipal Strategy at Barclays Plc.

"We were negative on munis to start the year," Foux said in an interview. But he said he's "slowly getting more positive, at least relative to Treasuries." Barclays doesn't expect a repeat of the January selloff.

"Getting closer to the summer when we'll have very larger redemptions, if supply doesn't pick up materially, I think we could potentially see some out-performance for munis sort of in the second half of the year," he said.

BlackRock’s Hayes Sees Muni Market Steadying Since January Rout

2018-04-04 16:04:03.403 GMT

By Amanda Albright

(Bloomberg) -- BlackRock Inc., the world’s largest money manager, thinks the outlook is improving for the $3.9 trillion municipal-bond market.

Peter Hayes, the head of the company’s municipal group, said returns have begun to recover from the January drop that pushed state and local debt to the biggest first-quarter loss in more than two decades. Municipals eked out a positive return of 0.37 percent in March, essentially erasing the loss suffered in February, according to Bloomberg Barclays indexes. "February and March were pretty much an offset," Hayes said at an event with reporters on Wednesday. "I think that’s the bigger story and level-sets how we feel about the market right now and where we stand."

Meanwhile, demand has stayed strong, with municipal-bond mutual funds continuing to attract cash despite the rout at the start of the year, Hayes added. Congress’ overhaul of the tax code left individual tax rates high, which will keep individual investors attracted to tax-exempt municipals, even though lower corporate levies may curb buying by some businesses, he said. The market is "still trying to figure out" what demand from buyers like banks and property and casualty insurers will be as a result of lower corporate tax rates, Hayes said.

"We’ve seen a fair amount of reallocation out of municipals on the part of property and casualty companies to places like investment-grade corporates," Hayes said. Hayes said he sees more value in the front end of the curve, which he said was rich a year ago. Shorter-dated municipals have been one of the few areas of the municipal market to notch positive returns in 2018.

"You’re getting paid for the first time in a while to actually stay in a short-duration asset," he said. "That’s going to be a bit important going forward around where performance will be derived -- at least for the next several months, until we get through this discovery period."

BN) Municipal Bonds See Biggest First-Quarter Loss in Two Decades

Municipal Bonds See Biggest First-Quarter Loss in Two Decades

2018-04-02 13:58:08.397 GMT

By Danielle Moran

(Bloomberg) -- Municipal-bond analysts expected a strong start for 2018 as sales of new securities dwindled after a record-setting December. Instead, state and local debt posted its biggest first-quarter loss in more than two decades.

Caught in the broader bond-market rout triggered by concerns the Federal Reserve will raise interest rates at a faster-than-expected pace, municipal securities lost 1.1 percent in the first quarter, the worst start to a year since 1996, according to the Bloomberg Barclays index. That was only slightly less than the 1.2 percent loss for Treasuries.

The performance belied expectations that the market would benefit from a drop in new debt sales after governments rushed to borrow in December before the federal tax overhaul did away with a key refinancing tactic. Even though money continued flowing into municipal mutual funds, that did little to buoy performance of tax-exempt securities -- whose prices are broadly driven by Treasuries.

"New issue supply, demand technicals certainly take a backseat when Treasury volatility is front and center," said Jonathan Law, portfolio manager for Advisors Asset Management Inc.

Morgan Stanley’s Zezas Sees Munis Recovering From Quarterly Rout

2018-04-05 17:59:20.876 GMT

By Amanda Albright

(Bloomberg) -- The outlook for the $3.9 trillion municipal- bond market is improving after investors saw a historically bad start to 2018, Morgan Stanley municipal strategist Michael Zezas said in an interview.

State and local government debt posted its worst first- quarter loss since 1996 amid fears about higher interest rates. Zezas said the Treasury market is the reason for his optimism about the rest of the year, anticipating that it will set the tone and cause the difference between long and short-term muni yields to narrow. Zezas is echoing a widespread sentiment among Wall Street analysts that the municipal market will recover from the first- quarter rout, which was caused by a selloff in January. The prices of the securities have since stabilized and money has continued to flow into mutual funds, boosting demand at a time when the pace of new bond sales is declining.

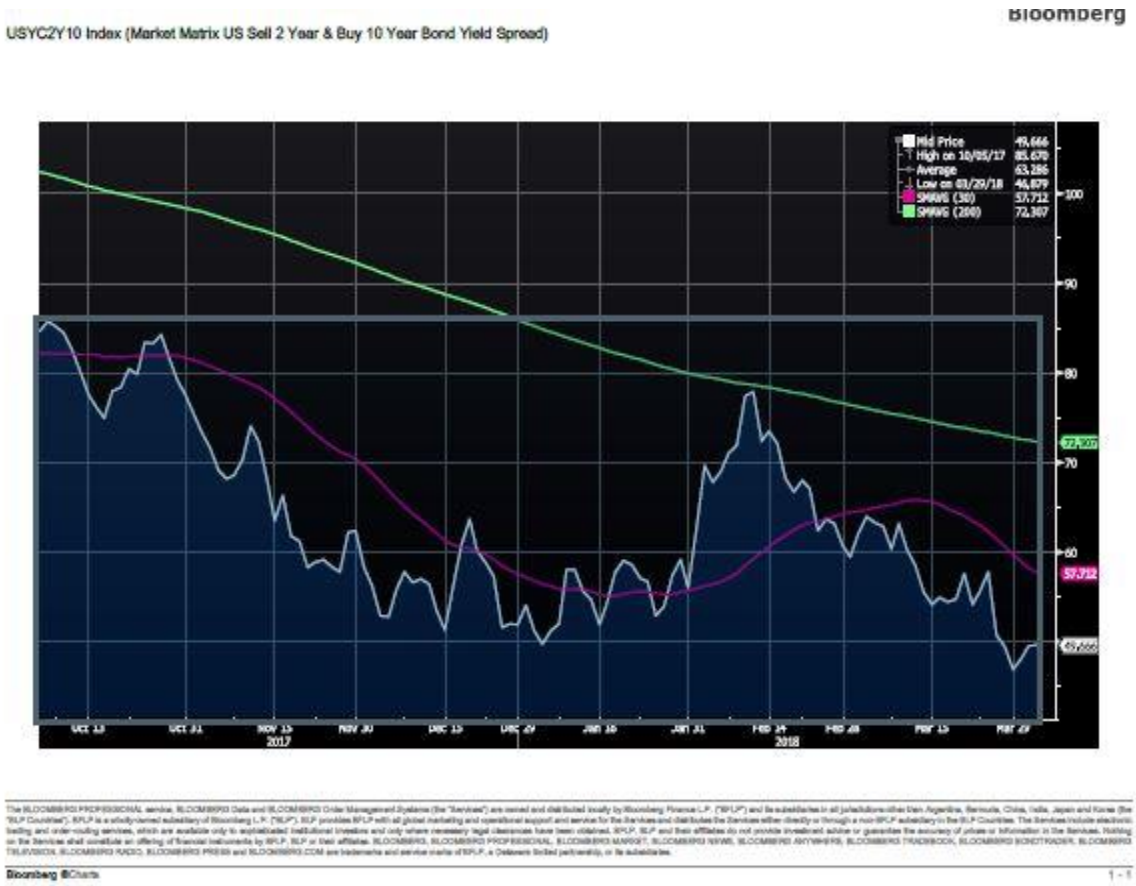
Related Story: Muni Analysts Have Brighter Outlook After Worst Start Since 1996

Municipal-bonds don’t historically perform well when the Treasury curve is steepening, Zezas said, and the chance of that happening if inflation picks up represents the "most palpable risk." He and his colleagues expect the Fed to raise interest rates three times this year. "If we’re wrong about our interest rate forecast, that’s the biggest risk," he said. "That really doesn’t have anything to do with the muni market specifically -- it has to do with inflation."

Long muni yields remain near the middle of their trading range for the last three years, but shorter maturities have seen the biggest increase.

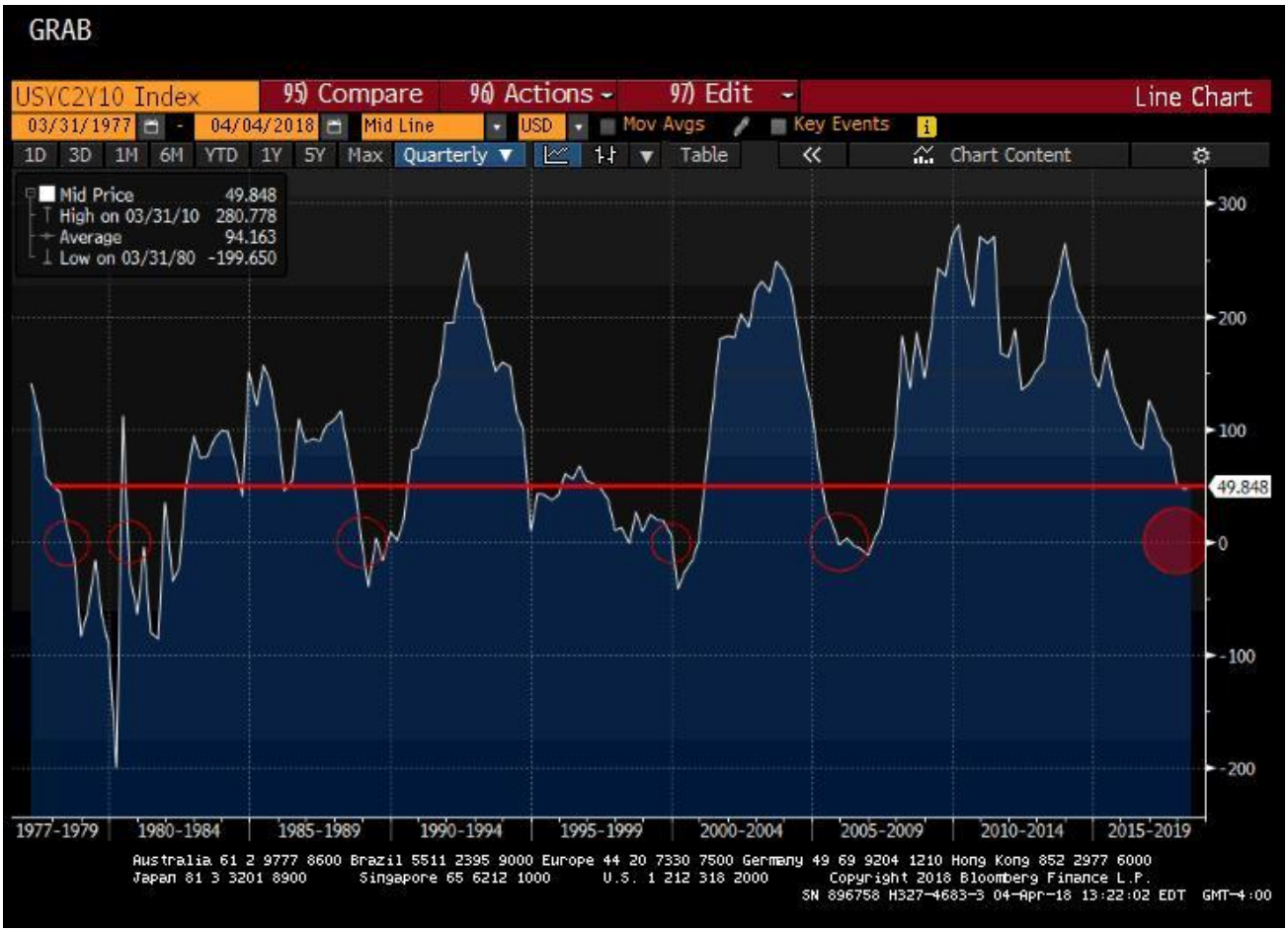
Figure 5. AAA MMD yield changes

Source: Citi Research and Thomson Reuters



The yield curve has flattened to the point that…..

…it has signaled a recession in the past.



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