A.H. Williams

Spinnaker Report

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AHW &Co Quarterly Commentary April 2020

The term Covid 19 or Coronavirus will now be etched in modern history as the worst financial and lifestyle changing event of our lifetimes. Much of this publication is dedicated to how we have dealt with the affects.

Our last newsletter focused on the challenge of navigating a market with tremendous tailwinds associated with lack of supply and continuously stronger demand. Our opportunistic trading strategy incorporating the realization of short-term profits while maintaining historically low leverage exposure worked successfully in 2019. We began 2020 holding heavier positions that we felt would appreciate as January and February usually experience stronger demand. This so called "January effect" traditionally provides an enhanced profit potential due to the excessive demand and unusually light supply. 2020 witnessed another strong "January effect" that continued into February. Fund flows were strong and included 56 consecutive weeks of inflows with over $100 billion added over this time frame. Municipal bond yields declined and became rich relative to US Treasuries. Percentage relationships shrank to abnormally low ratios. While we continued to opportunistically trade for profits, we simultaneously became more defensive with use of leverage and margin reducing our client portfolios to almost zero. In our opinion the risk vs. reward characteristics combined with margin costs at approx. 3.75% were unappealing.

The markets hate uncertainty but seemingly chose to ignore what was occurring in China and did not react to what turned out to be crisis until March. As the term "pandemic" was circulating world equity markets began considering the consequences of what an economic slowdown would have on company earnings, and sold off rapidly. US Treasury yields saw their lowest on record with the 10-year declining to approximately .30% and the 30 year to .60%. Initially this flight to quality led to higher municipal securities prices and the lowest yields ever recorded, which we elected to sell into. Initially the markets exhibited a traditional negative/inverse correlation as equity selling increased, eventually wiping out all 2020 gains and then all of the performance accumulated since the 2016 election (over 30%) and fixed income benefited as considered a safe haven.

Continued on next page

We had been preparing for a market slowdown and our perception was that more attractive yields were probable in March and our portfolios reflected this with shorter duration holdings and little leverage. Fund flows immediately stopped and a series of redemptions began. Forced selling by funds and ETFs accelerated a pace not seen since the early 1980's. Simply put, the buyers who had driven the market now were panic sellers and indiscriminate. In the span of one week yields rose to levels not seen in years or even decades. Everything was for sale and the shortest-term yields rose the fastest as managers needed to raise over $19 billion and $17 billion in a 2-week period. Short yields rose an average of 250 basis points and long yields approximately 200 basis points. Even though our AHW Co team has over 80 years of municipal bond experience moves of this magnitude are surprising to say the least. 9/11, the taper tantrum, Meredith Whitney's declaration of mass municipal bankruptcies, will be remembered as crises that produced significant market dislocations. Covid 19 is a game changer. Economic slowdowns are anticipated, not economic shutdowns. On March 28th, President Trump signed the $2 trillion stimulus bill. The bill expands the ability of the Federal Reserve to stabilize the markets as a liquidity provider of last resort. On March 22 rumors began that the Fed would potentially be permitted to purchase municipals of any duration. Immediately, the market began to firm and buyers emerged. Prices rose for 3 straight days coming close to recouping almost all of the losses related to the forced selling pressure. Many times we have mentioned that our strategies employ active trading methodology. AHW Co purchased securities and reflated the client portfolios after the first sell off and continued to purchase once the rumors began circulating about fiscal stimulus might include municipals. By doing so we were able to claw back performance lost during the liquidity event. To provide some clarity on the scope of the movement we have enclosed 2 graphs that show the magnitude of the movements. 10 year tax free vs UST ratios average range is 89%-100%. During this move municipal bonds were available at close to 400% of their taxable counterparts! In two weeks the market yields rose around 200 basis points or 2% higher yields than were available prior to the forced selling. It took only 3 days to retrace 145 basis points!

These are unheard of movements in a market that doesn't move much from week to week or even month to month.

At this juncture we are maintaining a slightly higher leverage factor driven by a couple developments. The Federal Reserve lowered rates to near zero and our current funding costs are now at 2.25%. This has allowed us to borrow at significantly lower rates than the securities we own and bought during this recent "fire sale" of municipal bonds. There are still probably some more price increases on the horizon and with this new tail wind we believe we will capture more of the upside.

The recently stabilizing actions by the government will allow the market to reopen and begin issuing badly needed new issues. We believe this will provide us even greater trading opportunities. While not perfect by any means, we were able to execute what we had planned for: 1- reduce exposure during market stress, 2- re-enter the market at significantly more advantageous yields. If nothing else this event and situation has demonstrated the value of the type of separately managed accounts. AHW Co clients were not subjected to any forced selling of portfolio holdings. Instead, we were able to view the market excessive movements as opportunities to purchase securities at unheard of discounts to the market.

Hopefully, this synopsis helps explain our strategy and the trades we have executed for the benefit of our clients.

Thank you for your continued support!

Biggest Muni-Bond Market Rally in Over a Decade Gains Force (2)
2020-03-25 16:19:24.755 GMT

By Danielle Moran

(Bloomberg) -- Municipal-bond prices surged, sending yields tumbling by the most in at least nine years, as Congress and the White House struck a deal on a more than $2 trillion stimulus package to soften the impact of the economic slowdown triggered by the coronavirus.

The yields slid sharply across maturities, including the shortest-dated securities that were hardest hit by the steep sell-off this month as fund managers dumped the easiest-to- unload bonds when investors fled en masse. Three-month benchmark yields dropped 43 basis points to 2.12% while those on 10-year bonds fell 38 basis points to 2.29%. Those on the longest-dated securities fell 36 basis points to 2.81%.

The rally gained force after the White House and the Senate reached an agreement on a massive package of spending and tax breaks in a bid to prevent the swift shutdown of much of America's economy from leading to a deep, prolonged recession.

It includes about $500 billion that can be used to back loans and assistance to companies, as well as state and local governments. The drop in yields Wednesday was the biggest since Bloomberg's benchmark indexes begin in 2011. It was roughly twice as big as the decline Tuesday, when the securities rallied the most since at least 2008, and included high-yield bonds that tumbled steeply during the sell-off.

"The stimulus will be very helpful to the overall market," said James Iselin, a portfolio manager at Neuberger Berman Group. He said on Tuesday the market had "really good two-way flow" and "direct buyers have become much more engaged, which is good to see."

"The stimulus will inspire confidence that a bridge is being built to help get us to the other side as we continue to deal with challenges resulting from this unprecedented moment," he said.

The two-day rally broke what had been an escalating slide in the $3.9 trillion municipal market as investors pulled cash out of mutual funds at a record-setting pace on concerns about how the economic fallout of the pandemic would affect cities, airports, hospitals and others that have issued tax-exempt bonds. The retreat saddled many borrowers with skyrocketing interest bills on floating-rate debt and effectively shut down the market for new debt issues as Wall Street banks put offerings on hold.

The Federal Reserve softened the liquidity strains by extending its lending programs to include some of the shortest-dated municipal securities, while the stimulus promises to soften some of the financial strains on local governments and other borrowers.

The municipal market has been whipsawed by unprecedented volatility this month, so it's not clear yet whether the rally is the start of a turnaround or a false start that could reverse if the pandemic worsens. But there are some signs that investors are swooping in to scoop up securities most affected by the sell-off.

On Wednesday, some of the most actively traded securities were floating-rate bonds issued by New York's water system, whose yields surged to 6.75% during the rout. Bonds backed by Ohio's tobacco-company legal settlement payments, a type of security that is a mainstay of high-yield funds, surged, with those due in 2055 climbing to an average of 89 cents on the dollar from about 75 cents Tuesday.

Puerto Rico's sales-tax backed debt -- which is a bellwether of the high-yield market that was dealt the steepest losses this month -- were also among the most heavily traded, with the price of those due in 2058 rising to an average of 87 cents on the dollar from about 80 cents Monday.

Muni-Bond Rally Accelerates, Extending Biggest Gain Since 1993
2020-03-26 18:10:16.212 GMT
By Danielle Moran

(Bloomberg) -- Municipal bonds rose sharply, extending the biggest rally in almost three decades, after the Senate passed a $2 trillion stimulus package that extends aid to state and local governments and gives the Federal Reserve the power to buy their debt to prevent a liquidity crisis like the one that raced through the market this month.

Yields tumbled by more than half a percentage point across maturities, driving those on 10-year benchmark securities down 55 basis points to 1.51%. Those on securities due in six months dropped 57 basis points, sliding to 1.23%.

The scale of the gain nearly matched the one seen in the $3.9 trillion market on Wednesday, when yields tumbled by about 60 basis points in the biggest one-day advance since 1993. The rally signals optimism that the federal stimulus package will help mitigate the impacts of the pandemic that has shut down large swaths of the economy and threatened to deal a major financial blow to states, cities, public transit systems and others that have sold tax-exempt debt.

Late Wednesday, the Senate approved a $2 trillion rescue plan that includes about $500 billion in loans and assistance for companies, including struggling airlines, as well as states and cities. The act allows the Fed to leverage that money to support the financial markets, including the one for municipal bonds. The House of Representatives is scheduled to vote on the legislation Friday and President Donald Trump said he would sign it immediately.

Citigroup Inc. strategists led by Vikram Rai said there’s “no doubt” that the stimulus plan will help state and local governments.

“Now that the Fed purchases can include municipal bonds, municipalities will now have a strong buyer helping to stem volatility and lower funding rates,” the strategists said. “This should go a long way towards aiding state and local governments in their time of need.”

The movement toward enacting the stimulus plan and the Federal Reserve’s earlier steps to shore up the market for the shortest-dated securities arrested what had been a mounting liquidity crisis in the municipal market, where waves of panicked selling erupted as investors yanked out cash. Even with the recent advance, that’s still left investors with the deepest losses since 1981. There are signs that investors may be wading back into the municipal market. They added $84 million to municipal-bond exchange-traded funds on Wednesday, with the Vanguard Tax-Exempt Bond ETF seeing a $46.6 million inflow after a wave of outflows the past two weeks.

“Municipal bonds as an asset class have been backstopped by both Congress and the Federal Reserve and with all of that are still very cheap historically to U.S. Treasuries,” said Michael Pietronico, chief executive officer at MT Asset Management LLC.

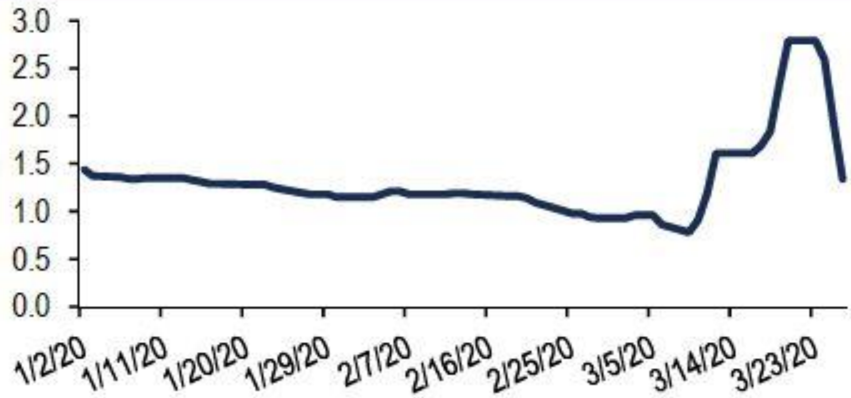
Earlier this week top-rated tax-exempt municipals were yielding 365% of comparable Treasury bonds. Julio Bonilla, a portfolio manager at Schroders, said the historic rout this month provided buying opportunities. He said he’s looking to purchase bonds sold by issuers with large cash reserves that can weather increased costs caused by the virus responses. “You don’t have to go down in credit quality now,” he said.

“That’s the beauty of it. You’re able to buy really high quality issues at distressed prices.”

Forced selling by mutual funds and ETF's produced extremely cheap municipal bond yields and opportunities

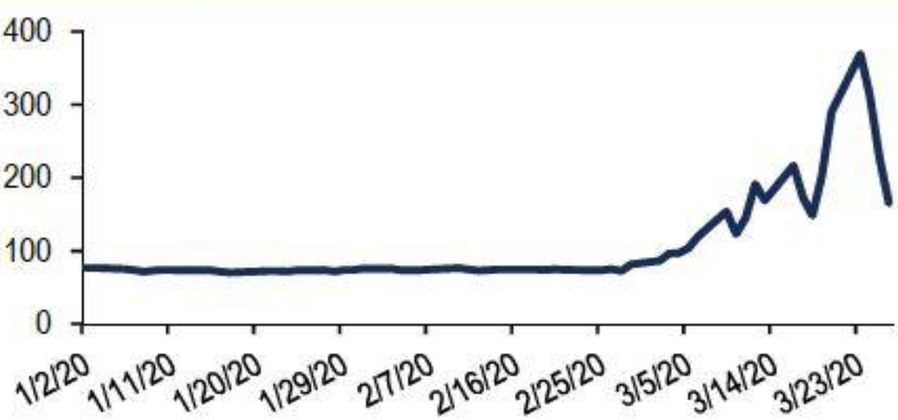
BofA GLOBAL RESEARCH

Chart 1: 10-year AAA rose 200bps in two weeks and fell 145bps in three days



Source: Thomson Reuters

Chart 2: We watch for 100% ratio and then 85% for the 10-year AAA



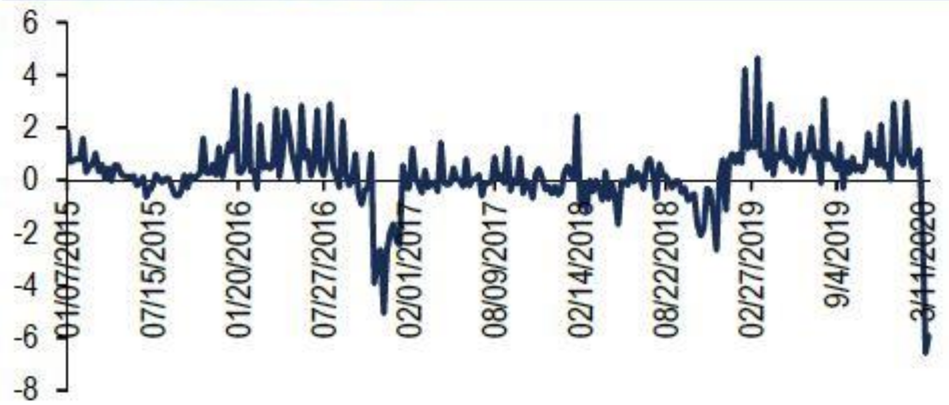
Source: Thomson Reuters

Relax, Muni Market Will Revive Quite Nicely: Joe Mysak
2020-03-26 15:15:25.342 GMT

By Joe Mysak
(Bloomberg) -- For its next trick, the municipal market will do what it does best: Reversion to the mean.
That's right, all the volatility that drove yields up by an unprecedented two points or more during the past couple of weeks as mutual funds and banks and investors sold bonds to raise cash -- it was all noise.
And spare me the hyperbole and hysteria about carnage. Prices fell and yields rose. Yes, by a lot, but if history is a guide, they'll settle back down soon. Yields will probably be more than 100% of U.S. Treasuries, and for some time, but 400% of Treasuries was unsustainable. Junk munis, too, will settle down.
What happens next?
We probably have to get used to outflows from municipal bond mutual funds and ETFs for a while, as retail investors raise cash and in some cases just cash out for fear of how states and municipalities will weather the pandemic.
But keep in mind that in June, July and August some $107.5 billion in municipal bonds will mature, according to data compiled by Bloomberg. Add in perhaps $10 billion of calls a month, and that's $140 billion looking for a new home, usually back in municipals. That $140 billion will likely outweigh new issue sales. In 2019, a very robust year, there were $100 billion in new bond sales during those three months, so that should provide support to the market.
For sure there's going to be pressure on states and localities as the economy contracts, and on some very particular sectors of the bond market, including those having to do with tourism, travel, conferences and sports. Some bonds may run into distress; others may violate debt service covenants. This doesn't mean an end to new speculative economic-development finance, but it may be a bit delayed.
The federal government is throwing a lot of money at the pandemic, and so is the Fed, so I'm taking a few things for granted: that the short-term market will go back to normal; that there will be no mass wave of bankruptcies of businesses small and large; no wave of housing foreclosures; no massive public-sectorlayoffs, and significant help for public transportation.
This probably still isn't enough to buy a V-shaped recovery, but it will mitigate the worst impacts of recession.
And in five or 10 years if we're lucky someone will look at a chart of 10-year, top-rated bond yields and ask, What happened

After 56 consecutive weeks of inflows fund managers had to scramble to raise cash to meet redemptions

Chart 21: Flow strength indicator*



Source: *The flow strength indicator is measured by 2-year trailing z-score (A positive or negative number does not necessarily suggest buying or selling). Lipper FMI. ETFs included. *Data includes both weekly and monthly reporting funds as of 25 March2020

Muni Bonds Reach Unheard-Of Cheapness Versus Treasuries
2020-03-24 12:55:09.876 GMT

By Amanda Albright
(Bloomberg) -- Two-year AAA municipals maturing in two years are yielding 934% what similarly-dated Treasuries do, signaling the securities are at their cheapest levels on record -- by far.
* The muni-Treasury ratio, a key gauge of relative value, has averaged 103.7% since 2000, according to data compiled by Bloomberg
** A higher ratio indicates that munis are viewed as cheap in comparison
* State and local debt has sold off steeply in March while Treasuries have rallied
* One-year top-rated munis are offering even more yield, with the muni-Treasury ratio reaching over 2,200%

Muni Bonds See Biggest Rally in a Decade as Record Sell-Off Ends
2020-03-24 20:32:35.362 GMT

By Amanda Albright and Danielle Moran

(Bloomberg) -- Municipal bonds staged the biggest one-day rally in at least nine years, rebounding from a record-setting sell-off, after the Federal Reserve moved to inject liquidity into the market and Congress edged closer toward agreement on a stimulus package to blunt the economic toll of the coronavirus pandemic.

Yields on 10-year benchmark tax-exempt bonds dropped 19 basis points to 2.67%, the first decline since March 9 and the biggest one-day slide since Bloomberg’s BVAL indexes begin in 2011. Those on the shortest-dated bonds, which had surged over the last two weeks as fund managers dumped the easy-to-sell securities to raise cash, dropped 28 basis points to 2.55%.

The pause is a welcome reprieve for a market that was deeply battered this month as investors pulled out at a record pace amid concerns about the economic and financial fallout from the coronavirus, triggering waves of forced selling by money managers.

That selling drove what’s usually a safe-haven to a more than 10% loss this month, its steepest since at least 1980, and saddled hospitals, transit systems and other borrowers with soaring interest rates on floating-rate bonds.

Last week, the Fed expanded its emergency lending program to provide liquidity to money-market funds so it would include purchases of short-term municipal bonds and, on Monday, it tacked on support for variable-rate debt. On Tuesday, stocks also gained as Congress inched closer toward reaching a compromise on the stimulus measure, which could weaken the hit faced by states, cities and others who borrow in the $3.9 trillion market.

The move to break the standoff in Washington is the main reason why tax-exempt bonds have started to recover, said Patrick Brett, head of municipal debt capital markets at Citigroup Inc.

“There is a bid today --- it’s on optimism that the stimulus is going to get done,” he said.

In Wreckage of Muni Market Crash, Brave Eye Bonds at 90% Yields
2020-03-24 15:29:48.916 GMT

By Amanda Albright

(Bloomberg) -- By some measures, the municipal-bond market is full of screaming buys for anyone brave enough to wade in. Take a note issued by New York's Metropolitan Transportation Authority that's due in about two months. It traded among securities dealers at yields as high as 11.2% on Friday and hit 90% the day before that -- an unheard of payout for securities that not long ago yielded 0.6%.

Bonds repaid with Ohio's share of the 1998 tobacco-company settlement that changed hands for as much as 116 cents on the dollar last month are now going for around 74 cents. Even so-called pre-refunded debt -- which is virtually risk free because it's paid off with federal government bonds that are held in an escrow account -- are yielding about 2.8%, more than triple 10-year Treasuries.

"At these levels there's value in the market," said Lyle Fitterer, co-head of municipal investments at Baird Advisors, who was referring to broader market conditions. "You can find some very good muni credits trading at levels you haven't seen in a decade."

The record-setting sell-off that raced through the market until this week has left broad wreckage in its wake, in part because of unprecedented uncertainty about how badly local governments, hospitals and public transit systems will be hurt by an economy that has virtually ground to a halt in a matter of weeks. States and cities have pleaded with the federal government for hundreds of billions of dollars in aid, showing how severe they expect the hit to be as tumbling stock prices, shuttered stores and masslayoffs cut deeply into their tax collections.

But as mutual-fund managers unloaded whatever they could to raise cash, some bonds that may have very little risk to the coronavirus shutdown tumbled as well. Even top-rated, two-year municipal debt is yielding 934% what similarly-dated Treasuries do, up from as little as 56% just in January.

Kyle Gerberding, director of trading for Asset Preservation Advisors, is focusing on the pre-refunded bonds since the Treasuries that backstop them essentially guarantee they won't default. "That's the biggest no-brainer trade," he said.

Wilmington Trust this week said it was moving taxable and tax-exempt accounts to an overweight position in investment-grade municipal securities after the spate of "indiscriminate selling."

BlackRock, Nuveen Unwind Leveraged Muni Trades Roiled by Havoc
2020-03-23 17:47:33.889 GMT

By Martin Z. Braun
(Bloomberg) -- Large municipal-bond funds run by BlackRock Inc., Nuveen, Pacific Investment Management Co. and Invesco Ltd. are unwinding a leveraged investment strategy that backfired this month, contributing to the flood of debt that's been unloaded during a record-setting sell-off.

Last week, fund companies began liquidating about 75 so-called tender-option bond trusts holding $1.2 billion worth of state and local government debt, according to data compiled by Bloomberg. The trusts issue floating-rate notes to money-market funds and use the cash to buy higher-yielding long-term bonds. Mutual funds seek to pocket the difference in yield between the two.

But the strategy is backfiring because yields on short-term debt have skyrocketed as investors pull cash out of money-market funds and banks struggle to resell the notes. A weekly index of tax-exempt debt with variable interest rates spiked to 5.2% on Wednesday, the most since 2008 and almost 2 percentage points more than yields on 30-year top-rated municipal debt.

To pay off short-term notes, mutual funds are selling municipal bonds held in the trusts as collateral. That has been putting more pressure on the market, which this month has suffered its biggest losses in at least four decades amid concern about the economic and financial fallout from the coronavirus.

"There comes a point where the rate gets too high and there's no money left for the investor," said Chad Farrington, a managing director at DWS Investment Management. "If funding costs get to certain level you must reduce the leverage."

On Monday, in an effort to relieve funding pressure in the muni market, the Federal Reserve agreed to purchase short-term securities from tax-exempt money market funds, including the variable rate demand obligations that make up almost 75% of short-term tax-exempt bonds, according to Citigroup Inc. While that appears to have eased some of the liquidity strains, with prices broadly unchanged Monday, short-term yields haven't come down.

Here's What's in the $2 Trillion Virus Stimulus Package
2020-03-26 05:20:11.120 GMT

By John Harney
(Bloomberg) -- The historic $2 trillion bill that was passed by the U.S. Senate late Wednesday to confront the coronavirus crisis will reach into many aspects of American life and business to stave off at least some of the economic damage to wrought by the pandemic.
The bill, now set for a U.S. House vote on Friday, will provide $500 billion in loans and other assistance to big companies as well as besieged states and cities, and $350 billion in aid to small businesses.
And the legislation will provide direct payments to most Americans and significantly bolster unemployment insurance benefits.
Here are the details of the 883-page bill.
* About $500 billion will be dedicated to loans and assistance to companies affected by the virus, as well as state and local governments. The Treasury Department will be charged with administering the program.
* Any company receiving a government loan would be subject to a ban on stock buybacks through the term of the loan plus one additional year. The companies also would have to limit executive bonuses and take steps to protect workers. In addition, borrowers have to make a "good faith certification" that they will stay neutral in any union organizing effort over the term of the loan.
* The deal includes $17 billion in loans for companies deemed critical to national security, which is intended to assist Boeing Co. though the legislation doesn't mention the company by name.
* For airlines, there will be $25 billion in grants, with conditions, and $25 billion in loans to passenger carriers, $3 billion to airline contractors providing ground staff such as caterers, while cargo haulers would see $4 billion in grants.
* Small businesses would receive more than $350 billion in aid, but they must agree to retain workers. Some business groups have already expressed concern about how long it will take for the businesses to get the money.
* Individuals are eligible for checks up to $1,200 and married couples filing jointly are eligible for checks up to $2,400, with an extra $500 for each child. The higher the income, the less money is received, with a cutoff for individuals earning more than $99,000 and couples with income above $198,000.
* Even people with no income and those on Social Security will receive payments.

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