APPLETON PARTNERS, INC.

This Week in the Bond Market
1/23/2017

Headline News

State and Local Tax Revenues Extend Growth Streak

- The U.S. Census Bureau announced that third quarter 2016 state and local tax revenues increased 2.2% compared to the same period in 2015. This represents the 20th consecutive quarter of growth extending back to late 2011.
- Although the rate of increase lagged the average quarterly revenue growth since the recession (3.4%), it marks an improvement from the marginal 0.1% increase experienced in the second quarter. Third quarter expansion was boosted by 3.2% growth in property taxes, which bodes well for local government budgets.

Muni Defaults Remain Rare

- Moody's reported that four issuers within its public finance portfolio defaulted for the first time in 2016, matching the same amount from the prior year. However, all four were associated with the Commonwealth of Puerto Rico, which has experienced a decade-long economic and fiscal decline.
- Excluding the Puerto Rico issuers, 2016 would have been only the second year in the last 14 in which no Moody's-rated municipal issuer defaulted. We would expect rated-issuer defaults to be infrequent, but the very low numbers coincide with a multi-year improvement in overall credit strength.

Sales of Short-Term Tax-Exempt Notes Decline

- For the sixth consecutive year, sales of fixed-rated short-term notes dropped in the municipal market as credit profiles broadly improved. Volume reached $31 billion in 2016, the lowest amount of sales since 2004. For comparison, municipalities sold close to $80 billion in 2010 as budget volatility and low reserves required external financing.
- Typically, tax revenues are collected later in fiscal years for municipal issuers, yet expenses are funded year-round. If reserves are healthy, issuers can rely on internal funds. But when revenues significantly underperform and/or reserves are insufficient, issuers will utilize short-term borrowing to plug the gap. A steady decline in short-term issuance indicates broader credit strengthening as balance sheets improve and revenues stabilize.

Market Update

Muni Market Overview

- The Municipal curve increased and steepened over the week to catch up with the Treasury. 5Yr Muni was higher by 9bps to 1.66% and the 7Yr moved up 16bps to 2%. The 10Yr Muni/Treasury ratio ended the week around 94%.
- Municipal bond fund flows turned around last week to show inflows of $1.126 billion. This is the first week of inflows following 9 weeks ($24.5 billion) of outflows since the election.
- The calendar for the week expects about $8 billion of issuance, which is lower than previous weeks but in line with the trailing 3yr average for the same time period. 30-day visible supply has also decreased suggesting near term supply may be below average.
- The total size of Municipal market has reached a new high of $3.83 trillion, which is 1.6% higher than its previous peak in the 4th quarter of 2010.

Corporate Market Overview

- The pace of Investment Grade Credit issuance slowed a bit last week as the MLK holiday, the inauguration, and earnings season blackouts kept issuers sidelined. The $48.7 billion of new debt was headlined by the post-earnings flood of a combined $18.75 billion issued by Bank of America, Well Fargo, and Morgan Stanley. Spreads remain in a very tight band with very little movement over the past several weeks.
- U.S. Treasury bonds remain range bound, with yields rising moderately from 5 years on out. The 10Yr benchmark bond ended the week up 7bps to 2.47% and the 30Yr bond rose 6 bps to 3.05%.

FIXED INCOME INDEX RETURNS AS OF 1/20/2017

	MTD	YTD
Barclays 3Yr	0.61	0.61
Barclays 5Yr	0.87	0.87
Barclays 7Yr	0.86	0.86
Barclays MM Short 1-5Yr	0.71	0.71
Barclays MM 1-10Yr	0.82	0.82
ML US Gov/Corp 1-10 Yr	0.05	0.05

Source: Interactive Data

APPLETON PARTNERS, INC. ONE POST OFFICE SQ. BOSTON, MA 02109 TEL. 617.338.0700 WWW.APPLETONPARTNERS.COM