APPLETON PARTNERS, INC.

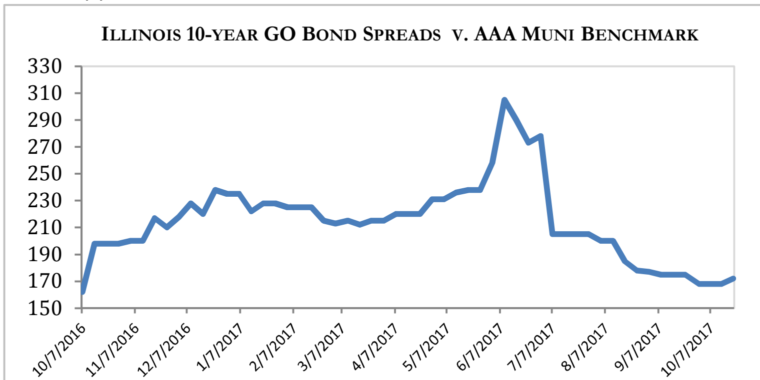
This Week in the Bond Market
10/23/2017

States in the Headlines: KY, PA, and CT

- ***Kentucky***'s Governor Matt Bevin and Republican leaders announced a pension reform proposal this past week that aims to ensure the solvency of the Commonwealth's poorly funded pension plans, as well as improve the affordability of the State's funding of retirement benefits. A number of changes were proposed, but the plan primarily revolves around switching new hires and those with 27 years or more experience from the current defined benefit offering to a 401(k)-style defined contribution plan. If approved, the greatest impacts will be experienced a number of years out, but in the short-term will improve the trajectory of Kentucky's unfunded pension liabilities, which were estimated to be over $40 billion as of the beginning of 2017. Similar to prior attempts by other states to implement comprehensive pension reform, we expect both political and legal challenges to the plan. Governor Bevin has stated a desire to hold a special legislative session before year-end to discuss the proposal.
- ***Pennsylvania***, now four months into its fiscal year without a budget, may be closer to a resolution following the Republican-controlled House of Representatives approving a revenue plan last week. Pennsylvania lawmakers approved a spending plan in July, but failed to agree on the necessary revenues to finance approximately $2 billion in costs. The House's package includes $1.5 billion in proceeds from a tobacco securitization bond issuance and $140 million a year from a host of tax increases. Both the Governor and Senate leaders stated they would analyze the bill; however, the House plan notably does not include a tax on Marcellus Shale drilling, a revenue generator that Governor Wolf has lobbied hard for inclusion. Previously, House Republicans stated a refusal to approve any budget that included tax increases, so the recent plan indicates some compromise.
- Also four months into its fiscal year without a budget, ***Connecticut*** may be moving closer to an agreement, as lawmakers announced a bipartisan budget deal was close to being finished and could possibly be voted on this week. Although details have not been released, the budget includes lower cuts to higher education than the previous plan, a requirement for teachers to pay more towards retirements, no sales or income tax increases, and an increase in taxes on the sale of cigarettes. Governor Malloy vetoed a prior budget approved by the legislature but may face more difficulty in rejecting this plan if lawmakers can garner strong enough support from both Democrats and Republicans. Also included in the budget was immediate support for the City of Hartford in the form of additional state aid and state-guarantees for a potential debt refinancing. Hartford's mayor has stated that the City may file for bankruptcy as early as November without additional funding from the State.

Muni Market Overview

- The shorter end of the muni curve came up slightly over the week with 5Yrs higher by 3bps to 1.37%; beyond 10Yrs, munis were also cheaper. In the 10Yr range, the curve was essentially unchanged. Over the week, munis outperformed Treasuries with the 10Yr Muni/Treasury ratio declining to about 82% from 86%.
- Supply is relatively large this week at about $10 billion, but issuance is dominated by $4.5 billion from the State of Illinois (Baa3/BBB-/BBB). 30-day visible supply is $14.4 billion, which is above the YTD average of $10 billion. Despite YTD issuance being 15% behind last year's issuance numbers, the month of October is expected to have positive net issuance. However, by December, the negative net issuance imbalance is expected to return and support the muni technicals.



Source: Thomson Reuters

Corporate Market Overview

- Investment Grade Corporate spreads continue to grind tighter. The Bloomberg Barclays IG OAS Index closed out last week with the tightest levels since 2007. The recent strength is coming from a better "risk on" sentiment and a lack of significant supply due to earnings blackouts. Last week's $25.3 billion in new issuance was a bit of a disappointment. Expectations were for closer to $35 billion, but feel short due to a surprising lack of issuance from the Financial sector. One of the most notable deals came from Glenmore Mines (GLENLN Baa2/BBB). They came with $500 million in both 5 and 10Yrs. Initial price talk was 20 – 30bps wider than where actual pricing came. The deal was well over 5 times oversubscribed for and came richer than where current GLENLN bonds were trading.

FIXED INCOME INDEX RETURNS AS OF 10/20/2017

	MTD	YTD
Barclays 3Yr	0.06	1.36
Barclays 5Yr	0.17	4.05
Barclays 7Yr	0.31	5.05
Barclays MM Short 1-5Yr	0.10	2.50
Barclays MM 1-10Yr	0.28	4.11
ML US Gov/Corp 1-10 Yr	-0.13	1.75

Source: Interactive Data

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