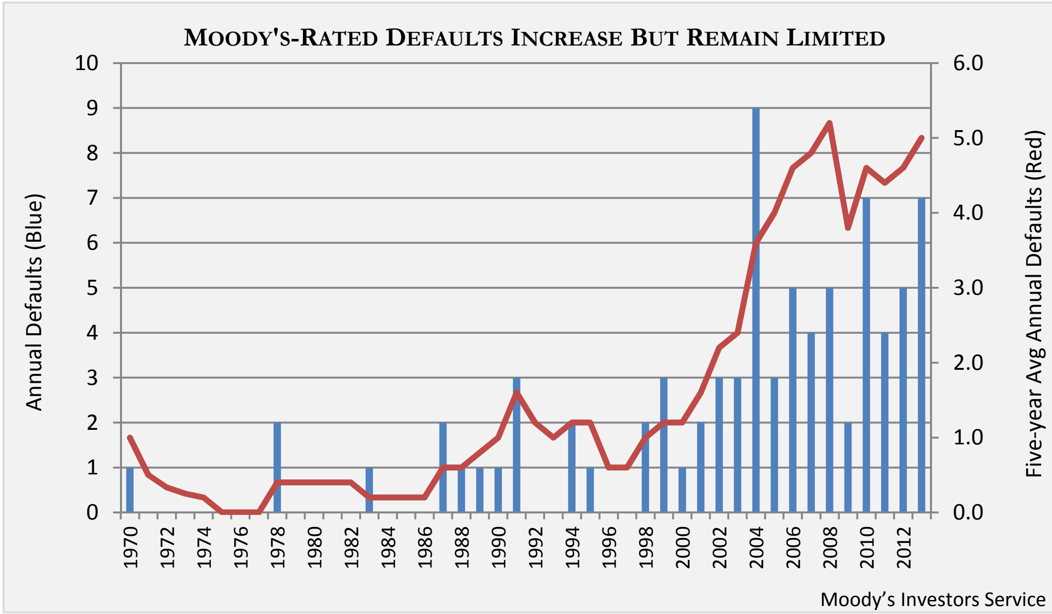
HEADLINE NEWS: HISTORICALLY LOW GLOBAL RATES PUSH INVESTORS DOWN THE CREDIT SPECTRUM

- Historically low global interest rates continue to push investors to take more and more credit risk in order to find adequate yields. According to the Financial Times, sales of CCC-rated bonds (i.e. just a few notches from default) have surged in the U.S. with over $13 billion sold through April. There appears to be more than enough demand for the most risky credits, with total returns on CCC-rated debt up 10.5% YTD versus just 4% for the broader high-yield market. Similar to their commentary on the froth in the leverage loan market, central bankers have hinted at concerns over the growing sales of junk-related bonds.
- Moody's released its annual US Municipal Bond Defaults and Recovery Study, which analyzes default information for the period of 1970 through 2013. While the headline will read "Defaults Remain Elevated Compared to Historical Experience," the underlying story is that defaults continue to be limited in nature. Out of 15,700 public finance ratings, Moody's experienced seven defaults in 2013, three of which were related to the City of Detroit. To put that in perspective, the one-year default rate for municipal issuers remains very low at 0.013% compared to 1.67% for corporate issuers.



- California's Office of the State Controller indicated that state revenues for the month of April were $303 million *above estimates*, bringing the fiscal YTD outperformance over budgeted expectations to $2.17 billion. The numbers are even better considering that April is a significant month for California's budget (on average 15% of annual revenues) and the state was budgeting off of last year's figures that were "inflated" due to tax-avoidance strategies in late 2012. Rating agencies and the Rockefeller Institute have cautioned that some states may be in for a rude awakening when April revenues are collected. California's conservative budgeting and ability to avoid an unpleasant revenue surprise continues a trend of positive credit developments for the state.

MARKET UPDATE: STRONG FIXED INCOME DEMAND CONTINUES TO PUT PRESSURE ON SPREADS

- As we have noted previously, Municipal new issue volume is running considerably lower than in prior years, with YTD 2014 coming in at $89.2 billion through April. The last time volume was this low was 2006. This has driven credit spreads tighter, with the spread between 20Yr "A" rated and "AAA" rated GOs currently at 71 bps. While this is the tightest spread YTD, the spread was 28 bps back in 2006, according to Municipal Market Data. It is important to remember however, that back in 2006, a majority of the market was covered by bond insurance, so there were few "A" rated GOs. However, our point is that further spread compression is possible given the current lack of issuance and strong demand for Municipals.
- The downward trend in US Treasury 30Yr rates halted last week as the demand YTD in 2014 showed signs of hitting some resistance. The yield rose 10 bps to close out the week at 3.46%. This move was triggered by a weak 30Yr bond auction on Tuesday signaling a decrease in demand. However, the 30Yr has dropped 50 bps so far this year and the 2Yr – 30Yr spread is 311 bps, reminding us that the curve is still incredibly steep. Despite this, Investment Grade Corporates continue to be resilient with little to no change in spreads.

FIXED INCOME INDEX RETURNS

	MTD 5/9/14	YTD 5/9/14
Barclays 3Yr	0.10	0.72
Barclays 5Yr	0.21	1.78
Barclays 7Yr	0.24	3.55
Barclays MM Short 1-5Yr	0.10	0.66
Barclays MM 1-10Yr	0.20	2.48
ML US Gov/Corp 1-10 Yr	0.25	1.58

Source: IDC

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