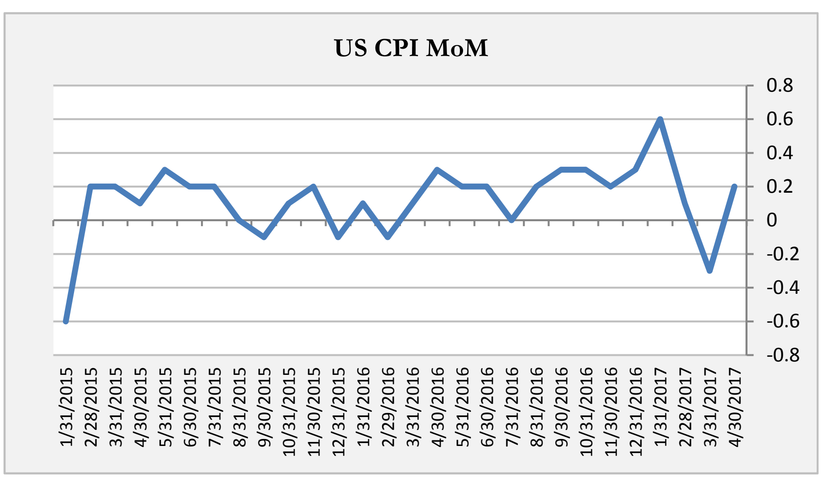
State Sector - Stagnant Revenue Growth Leads to Modest Borrowing

- According to a report released by Moody's, debt issued by state governments increased by only 0.8% in the twelve months ending June 30, 2016, the fourth consecutive year of sub-1.0% growth. In the same week the Rockefeller Institute released a report that partially explains the limited growth in borrowing - total state tax revenues grew a modest 1.2% for the same period.
- Since the financial crisis, we have seen both state and local governments reluctant to take on additional debt, with a focused effort to deleverage their balance sheets. As we approach the late innings of the economic recovery, indicated by the relatively low growth in revenues, it may be difficult to make the case for now increasing investment in deferred projects.
- To cover what the American Society of Civil Engineers reports as a 10-year, $2 trillion infrastructure investment gap, we believe we will see greater issuance coming from the municipal market, but it will most likely be driven by revenue-backed issuers, such as water utilities, transportation authorities, and public power providers.
- Year-to-date, states have issued 12.9% less debt than the prior year, according to Thomson Reuters. In contrast, state agencies, often backed by dedicated revenues have seen a 3.7% increase in borrowing.

US 10Y Treasury Yield



Source: Bureau of Labor Statistics

Muni Market Overview

- Munis were tighter and flatter over the week with the 5Yr down 3bps to 1.38% and the 7Yr down 5bps to 1.66%. 2Yrs to 10Yrs flattened by 4bps to 114.
- Looking forward, we expect about $8.5 billion in new issuance, led by $2.1 billion Hudson Yards Infrastructure Corporation (Aa3/Exp). Quality deals in the near term are likely to be well received as we are approaching the June-August period with expected net negative issuance of $48 billion.
- Mutual Funds experienced positive flows for the 5th straight week, at $999 million, bringing the year-to-date total to about $3.2 billion.

Corporate Market Overview

- The US Treasury yield curve was flatter by the end of the week following reports of some decent economic and inflation data, but weaker than expected retail sales and CPI kept yields at bay. The 5Yr & 7Yr part of the curve were down 3 bps to 1.85% and 2.13%, respectively, and the 10Yr dipped by 2 bps to 2.33%
- Investment grade issuance continues to be average with only $39.17 billion of new debt tapping the market last week. The trend is higher than the past several weeks, but lighter than anticipated. Additionally, the new issue concession that has been prevalent in the past has vanished as new deals are coming closer to where bonds are trading in the secondary. The overall tone of the Investment grade market continues to be very strong as spreads are at or near the year-to-date tights that we experienced in early March.

FIXED INCOME INDEX RETURNS AS OF 05/12/2017

	MTD	YTD
Barclays 3Yr	0.24	1.81
Barclays 5Yr	0.38	2.99
Barclays 7Yr	0.47	3.39
Barclays MM Short 1-5Yr	0.26	2.01
Barclays MM 1-10Yr	0.41	2.91
ML US Gov/Corp 1-10 Yr	-0.03	1.14

Source: Interactive Data

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