APPLETON PARTNERS, INC.

This Week in the Bond Market 09/25/2017

Hurricane Maria Batters Puerto Rico

- Hurricane Maria made landfall in Puerto Rico early last Wednesday with winds reaching nearly 155 miles per hour, knocking out electricity across the island. Already reeling from $1 billion in damage caused by Hurricane Irma, some experts are estimating that Maria was responsible for $30 billion of damage in Puerto Rico.
- Puerto Rico is in the midst of a restructuring, which most likely will be delayed as focus on the island now shifts to assessing the damage, restoring essential services to citizens, and eventually, rebuilding. Significant financial assistance, through federal funding or some other source, such as private investment, will be required. Population outmigration, an underlying pressure on the Commonwealth's economy for years, may also increase.

Tax Reform Blueprint to be Released

- The "Big Six," which includes House Ways and Means Committee Chairman Kevin Brady and Treasury Secretary Steve Mnuchin, among others, is expected to release a framework for federal tax reform this week. Past comments by officials, including Mnuchin, indicate that the tax-exempt status of municipal bonds will be most likely be preserved.
- However, the elimination of the state and local tax deduction could be on the chopping block. The Tax Policy Center estimates that the deduction will cost the federal government $96 billion in 2017 and critics argue it favors high-tax states such as California, New York and New Jersey.
- If the deduction is eliminated it may very well increase the demand for municipal bonds as taxpayers look for alternatives to lower their overall tax liability. Without the benefit of the deduction, taxpayers in high income tax states would also likely increase the demand for in-state paper, looking to maximize the benefits of the municipal bond exemption.

Illinois to Issue $6 Billion in GO Bonds

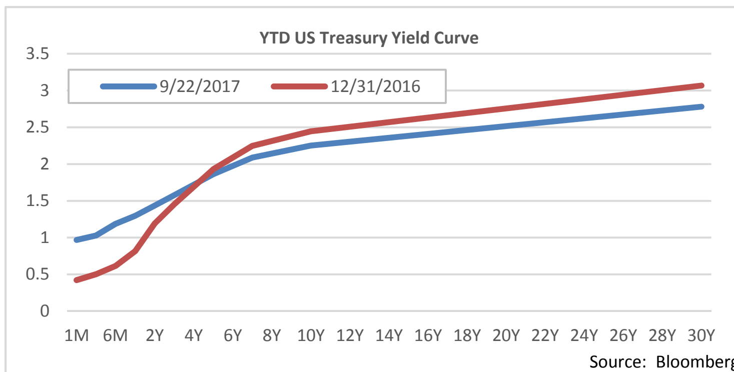
- As part of the July budget deal that ended nearly two years of political gridlock on a spending plan, Illinois legislators also included a provision that would allow the State to issue $6 billion in General Obligation Bonds to help alleviate a more than $15 billion unpaid bill backlog.
- Despite reluctance to utilize the authorization, Governor Rauner announced last week that Illinois will issue the full $6 billion, likely in October. Under state GO statutes, Illinois must sell the first 25% of the deal as competitive, with $1.5 billion to be issued in that manner. Soon after, the remaining $4.5 billion will be issued through a team of more than 10 pre-approved underwriters. Maturities are capped at no more than 12 years.
- Any delay in the deal may put pressure on Illinois' liquidity. The authorization requires the deal to be sold prior to December 31, 2017.

Muni Market Overview

- On the whole, Munis were higher over the week following the Treasury widening after the FOMC release. The largest change was the 6Yr part of the curve up 7bps to 1.40%. The Fed is starting the balance sheet normalization next month and the implied probability of a rate hike in December increased to over 70%.
- Supply picked up with $10 billion expected for the week, about $2.5 billion higher than the year-to-date weekly average. 30-day visible supply also jumped to $16.2 billion, which is the highest since mid-June.

Corporate Market Overview

- The Federal Reserve meeting and the release of the minutes from their July meeting took center stage last week. There were no real surprises but the three take-a-ways were:
    1. A December Fed Funds Rate hike of 25bps to 1.25% – 1.50% is more likely;
    2. Beginning in October, the Fed will begin to roll off up to $10 billion of maturing securities from the Fed balance sheet;
    3. The longer-run forecast end cycle rate was lowered from 3.00% to 2.75%. In response, the US Treasury curve continued to flatten. The 3, 5, 7, and 10Yr rose by 5-6 bps with the 5Yr rising 12bps since the beginning of September. The 30Yr was basically unchanged at 2.70%.
- IG Corporate issuance was jammed in to the first two days of the week prior to the Fed meeting release on Wednesday. Of the $18.345 billion issued, $2.5 billion was SAS and mostly issued in the 10Yr part of the curve. The lack of new issuance drove spreads tighter on the week driving them closer to YTD tights.



FIXED INCOME INDEX RETURNS AS OF 09/22/2017	MTD	YTD
Barclays 3Yr	-0.13	2.56
Barclays 5Yr	-0.41	4.17
Barclays 7Yr	-0.43	5.09
Barclays MM Short 1-5Yr	-0.25	2.65
Barclays MM 1-10Yr	-0.43	4.18
ML US Gov/Corp 1-10 Yr	-0.40	1.98

Source: Interactive Data

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