# MONTHLY REVIEW

May 2019

MAINLINE WEST

## May 2019 Muni Market Monthly Report – "Muni Summer Technicals and Market Performance"

A strong Treasury rally during the month of May, for various questionable (and unquestionable) reasons, helped munis continue to rise in price. Although munis greatly underperformed, we still see a positive trend for the next 30 to 60 days. *Simply put, there is too much cash chasing too few bonds.*

Entering the summer months of 2019, supply and demand technicals look strong for munis. This fundamental seasonal effect comes about from a mismatch of new bond issuance and bond proceeds (calls, coupon payments and maturities) that happens every summer. This month, we look at how this seasonal effect has impacted muni performance and its relationship with taxable bonds. There is an estimated $17 billion of net cash available for investing after planned new issuance this summer. *Does this guarantee outperformance and price appreciation for munis?*

## Muni Market Review

The muni market continues to rally in 2019, but finally could not keep up with the crazy-strong taxable market. Investors feel the economy is going to slow down and there will be rate cuts in the second half of the year. *This, combined with stock market losses, has spurred the strongest 1-month rally since 2008 in US Treasuries.* Highlights of the muni market performance in May are as follows:

- Muni yields were down 19 to 23 bps, and an influx of cash is dampening the 7-day floating rate to roughly 58% of 1 month Libor. The historic average is at 70%. This reflects the amount of cash waiting to buy longer-term munis.
- Taxable yields were down 40 to 41 bps.
- Inflows into muni mutual funds have been positive every week since the first week of January. This, combined with an estimated negative $17.2 billion in net supply, has the muni market looking for bonds.
- Year-to-date, muni issuance has picked up and is now higher than YTD 2018, but it remains low versus recent history:
    - 2019 is up 1.3% versus 2018.
    - 2019 is down 27.2% versus the last 5 years' average.

Things continue to look technically and fundamentally strong for positive muni performance over the next 30 to 60 days. *The current NAVs of the Tax Advantage Opportunity Funds are elevated and total returns impressive, but the prospects for deployment Fund VI does not appear imminent.*

## Market News and Credit Update

*Infrastructure Plan?* Remember the headline: "Democrats and Trump reach a tentative $2 billion infrastructure plan"? That was short-lived, and now it appears the municipal market is back to providing the financing. Consequently, issuers are fearful of taking on more debt after the 2008-2010 debt crisis. Washington DC needs to find a way to help them out. Does this set the stage "Build America Bonds – Round II"?

*The top five states for personal income tax growth in 2017:* California, Texas, New York, Florida, Illinois. The bottom five states were Vermont, Wyoming, Alaska, North Dakota and DC. The big keep getting bigger!

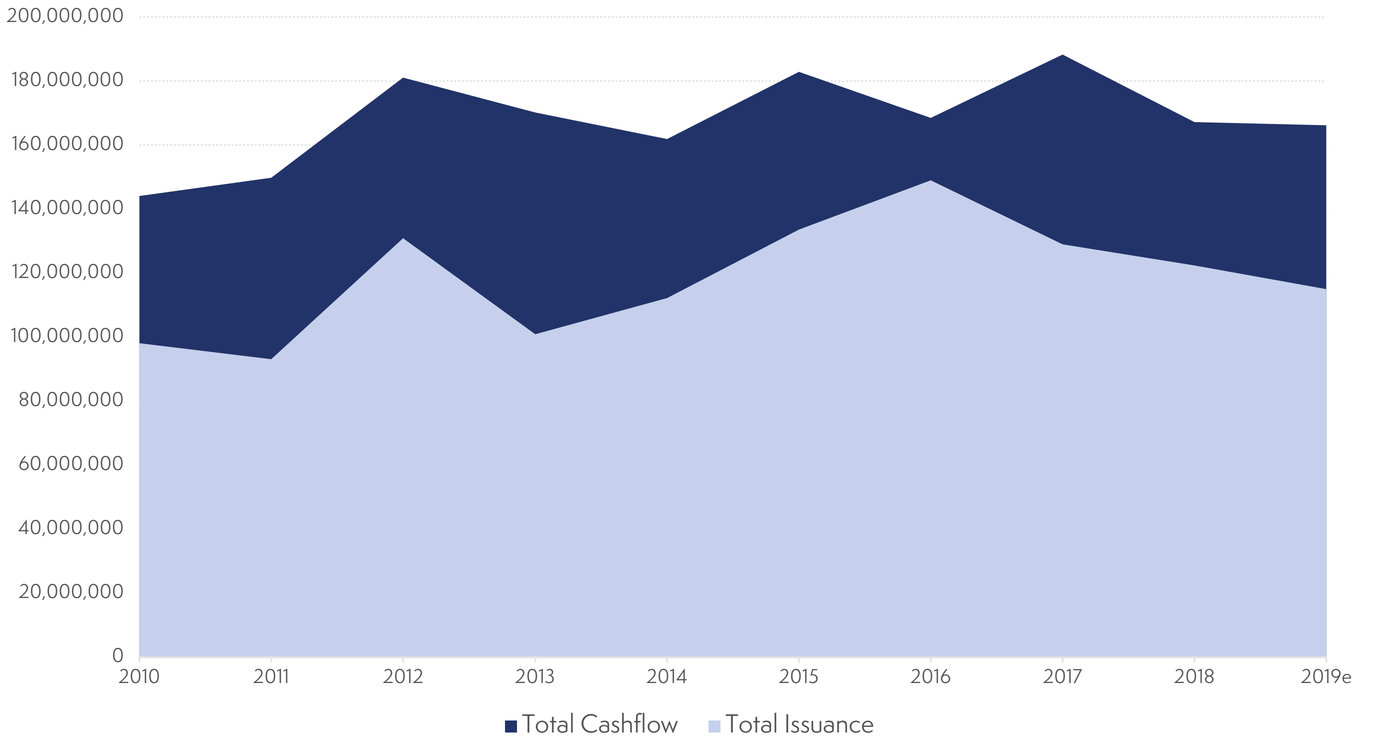
*Philadelphia and Baltimore have filed a joint lawsuit* against various Wall Street Banks alleging wrongdoing in the variable rate market. The lawsuits claims that the banks conspired to reset variable borrowing rates higher than they should have been. They claim the banks did this so they did not have to worry about remarketing the floaters. We are not surprised by these claims and they are probably true. It simply means the banks will increase remarketing fees in the future, as these banks will not provide this service without meeting profit objectives. *MainLine does not feel this will influence the funding rate for the Tax Advantaged Opportunity Funds.*

## A Historical Review on Strong Summer Technicals & Market Performance:

The supply and demand balance in the muni market is an important technical that can greatly influence market performance over a short-term time horizon. This influence is greatest during the months of May to August where maturities, calls, and coupon payments run very high and issuance remains stable to lower. This imbalance (large cash amounts available for reinvestment versus newly issued bonds) is a bullish technical for the muni market. Market improvement in prices and outperformance versus taxables has not always been the net result. We will review how the muni market has performed over the last nine years during this bullish "summer" technical period, and see if we can predict 2019!

Let's look at this imbalance and define the technical strength it shows through the years.

## Total Cashflow vs New Issuance May to August 2010 to 2019




| May to August - $ in mlns | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019e |
|---|---|---|---|---|---|---|---|---|---|---|
| Bonds Maturing | 73,076 | 78,180 | 82,115 | 91,276 | 84,563 | 90,407 | 85,913 | 108,226 | 103,569 | 111,083 |
| Bonds Called | 27,724 | 28,419 | 55,918 | 34,631 | 35,772 | 51,660 | 39,881 | 37,052 | 21,081 | 12,584 |
| Coupon Payments | 43,295 | 43,182 | 43,042 | 44,248 | 41,538 | 40,762 | 42,652 | 43,004 | 42,552 | 42,555 |
| Total Monthly Cashflow | 144,095 | 149,782 | 181,076 | 170,156 | 161,873 | 182,829 | 168,445 | 188,282 | 167,202 | 166,221 |
| New Issuance | 98,176 | 93,103 | 130,875 | 100,887 | 112,212 | 133,595 | 149,014 | 129,022 | 122,446 | 115,000 |
| Excess Cash/Shortage of Cash | 45,919 | 56,679 | 50,201 | 69,269 | 49,662 | 49,234 | 19,431 | 59,260 | 44,756 | 51,221 |
| **% Shortage** | **32%** | **38%** | **28%** | **41%** | **31%** | **27%** | **12%** | **31%** | **27%** | **31%** |

On average, cash available (demand) is greater than issuance (supply) by $50 billion, meaning only 70% of the cash can be reinvested in new muni bonds. This should cause muni investors to bid up the price on all muni bonds if they want to remain in the tax-exempt market. The other alternative is to reinvest the proceeds in another asset class or remain in cash.

The chart below illustrates how the muni market has performed from May to August each year from 2010 to 2018, and then compares it to the USD Swap market.

| | Muni Yields & Change | | | | USD Libor Yields & Change | | | | Muni/Swap Ratio & Change | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 5 | 10 | 15 | 30 | 5 | 10 | 15 | 30 | 5 | 10 | 15 | 30 |
| 04/30/10 | 1.79% | 3.14% | 3.83% | 4.44% | 2.67% | 3.66% | 4.05% | 4.29% | 67.04% | 85.79% | 94.57% | 103.50% |
| 08/31/10 | 1.08% | 2.33% | 3.44% | 4.08% | 1.56% | 2.48% | 2.87% | 3.14% | 69.23% | 93.95% | 119.86% | 129.94% |
| 2010 | -0.71% | -0.81% | -0.39% | -0.36% | -1.11% | -1.18% | -1.18% | -1.15% | 2.19% | 8.16% | 25.29% | 26.44% |
| 04/30/11 | 1.60% | 3.17% | 4.00% | 4.65% | 2.15% | 3.37% | 3.85% | 4.16% | 74.42% | 94.07% | 103.90% | 111.78% |
| 08/31/11 | 0.95% | 2.34% | 3.52% | 3.97% | 1.27% | 2.40% | 2.89% | 3.25% | 74.80% | 97.50% | 121.80% | 122.15% |
| 2011 | -0.65% | -0.83% | -0.48% | -0.68% | -0.88% | -0.97% | -0.96% | -0.91% | 0.38% | 3.43% | 17.90% | 10.38% |
| 04/30/12 | 0.88% | 2.02% | 3.17% | 3.63% | 1.09% | 2.05% | 2.50% | 2.82% | 80.73% | 98.54% | 126.80% | 128.72% |
| 08/31/12 | 0.77% | 1.96% | 2.97% | 3.35% | 0.77% | 1.66% | 2.12% | 2.47% | 100.00% | 118.07% | 140.09% | 135.63% |
| 2012 | -0.11% | -0.06% | -0.20% | -0.28% | -0.32% | -0.39% | -0.38% | -0.35% | 19.27% | 19.54% | 13.29% | 6.90% |
| 04/30/13 | 0.80% | 1.92% | 2.85% | 3.11% | 0.84% | 1.84% | 2.39% | 2.81% | 95.24% | 104.35% | 119.25% | 110.68% |
| 08/31/13 | 1.55% | 3.20% | 4.18% | 4.48% | 1.84% | 2.98% | 3.42% | 3.72% | 84.24% | 107.38% | 122.22% | 120.43% |
| 2013 | 0.75% | 1.28% | 1.33% | 1.37% | 1.00% | 1.14% | 1.03% | 0.91% | -11.00% | 3.03% | 2.98% | 9.75% |
| 04/30/14 | 1.24% | 2.69% | 3.62% | 4.09% | 1.75% | 2.75% | 3.16% | 3.45% | 70.86% | 97.82% | 114.56% | 118.55% |
| 08/31/14 | 1.14% | 2.17% | 2.60% | 3.15% | 1.77% | 2.49% | 2.81% | 3.07% | 64.41% | 87.15% | 92.53% | 102.61% |
| 2014 | -0.10% | -0.52% | -1.02% | -0.94% | 0.02% | -0.26% | -0.35% | -0.38% | -6.45% | -10.67% | -22.03% | -15.94% |
| 04/30/15 | 1.33% | 2.12% | 2.57% | 3.12% | 1.58% | 2.12% | 2.27% | 2.53% | 84.18% | 100.00% | 113.22% | 123.22% |
| 08/31/15 | 1.41% | 2.21% | 2.63% | 3.08% | 1.64% | 2.25% | 2.50% | 2.73% | 85.98% | 98.22% | 105.20% | 112.82% |
| 2015 | 0.08% | 0.09% | 0.06% | -0.04% | 0.06% | 0.13% | 0.23% | 0.20% | 1.80% | -1.78% | -8.02% | -10.40% |
| 04/30/16 | 1.04% | 1.65% | 2.07% | 2.54% | 1.27% | 1.73% | 1.98% | 2.21% | 81.89% | 95.38% | 104.55% | 114.93% |
| 08/31/16 | 0.89% | 1.43% | 1.75% | 2.14% | 1.22% | 1.44% | 1.58% | 1.70% | 72.95% | 99.31% | 110.76% | 125.88% |
| 2016 | -0.15% | -0.22% | -0.32% | -0.40% | -0.05% | -0.29% | -0.40% | -0.51% | -8.94% | 3.93% | 6.21% | 10.95% |
| 04/30/17 | 1.45% | 2.16% | 2.59% | 3.00% | 1.93% | 2.25% | 2.41% | 2.52% | 75.13% | 96.00% | 107.47% | 119.09% |
| 08/31/17 | 1.12% | 1.83% | 2.32% | 2.73% | 1.76% | 2.07% | 2.24% | 2.38% | 63.64% | 88.41% | 103.57% | 114.71% |
| 2017 | -0.33% | -0.33% | -0.27% | -0.27% | -0.17% | -0.18% | -0.17% | -0.14% | -11.49% | -7.59% | -3.90% | -4.38% |
| 04/30/18 | 2.20% | 2.53% | 2.83% | 3.14% | 2.92% | 2.99% | 3.03% | 3.02% | 75.34% | 84.62% | 93.40% | 103.97% |
| 08/31/18 | 2.03% | 2.46% | 2.78% | 3.07% | 2.88% | 2.93% | 2.97% | 2.96% | 70.49% | 83.96% | 93.60% | 103.72% |
| 2018 | -0.17% | -0.07% | -0.05% | -0.07% | -0.04% | -0.06% | -0.06% | -0.06% | -4.86% | -0.66% | 0.20% | -0.26% |
| 04/30/19 | 1.64% | 1.89% | 2.24% | 2.64% | 2.32% | 2.49% | 2.61% | 2.69% | 70.69% | 75.90% | 85.82% | 98.14% |
| 08/31/19 | | | | | | | | | | | | |
| 2019 | | | | | | | | | | | | |

Review of the data:

- Of the nine summers reviewed, munis outperformed taxables four times (highlighted in black).
- Of the nine summers reviewed, rates declined seven times (highlighted in black).
- The short-end of the curve (5 years) seems to be the most consistent "outperformer" doing so six times out of the nine summers.

## Conclusions:

- The supply and demand technicals are very bullish with supply covering, on average, only 70% of demand. Yet, ***there is no consistent trend of muni performance with this technical strength of supply/demand in the summer months***.
- There appears to be a ***slight bias on the short-end of the muni curve 5 years and in*** as having the best chance to outperform.
- ***Technicals for 2019 look strong, but history does not show that it is a given that munis will outperform taxables.*** Most likely, other factors will influence the final performance results for munis during the summer of 2019.