

Municipal Bonds Riding the Wave



James Pass
Senior Managing Director



Allen Li, CFA
Managing Director



Michael Park
Vice President

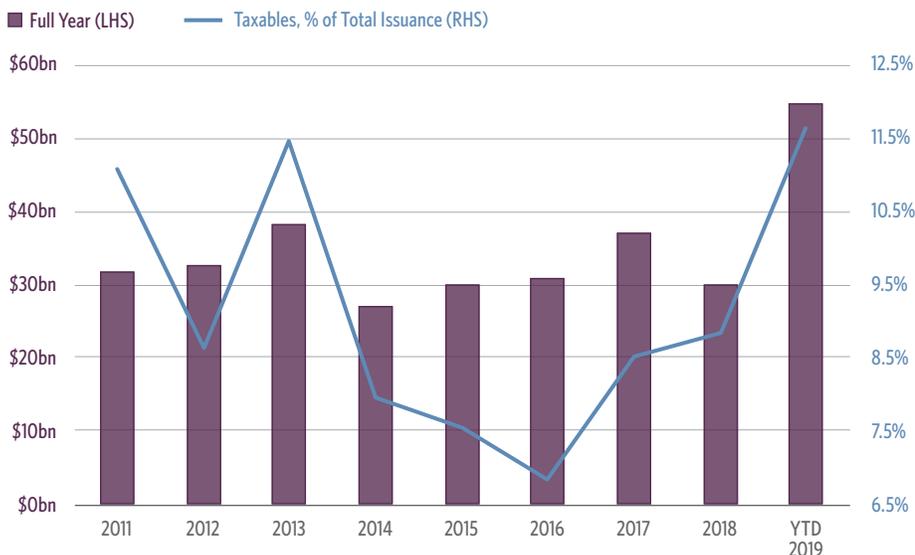
Continued strong demand enables a move up in credit quality.

After reaching all-time lows in municipal-to-Treasury ratios in May, municipals' performance began to experience relative softness throughout the third quarter. While long-duration Treasury yields fell to all-time lows in August, ratios reset to higher levels, contributing to the end of 10 consecutive months of positive performance for the Bloomberg Barclays Municipal Bond index. The municipal market's streak of consecutive weekly inflows continued for 2019, accumulating to \$86 billion year to date, offsetting the 11 percent year-over-year increase in new issue supply.

Taxable new issuance, which surpassed \$50 billion for the first time since the Build America Bonds program in 2009-2010, boosted overall supply (see chart, top right). Attracted to name diversification, lower default probability, healthy ESG factors, and lower correlations to corporate markets, crossover buyers welcomed the surge in taxable new issuance. Since September, issuers have capitalized on the Treasury rally by issuing taxable bonds not only for new money, but for advance refunding of tax-exempt bonds. Although the Tax Cuts and Jobs Act eliminated advance refundings with tax-exempt bonds, the arithmetic of the current rate environment has encouraged issuers to execute similar financing strategies with taxable bonds several years ahead of par call dates. Low absolute yields, combined with the Treasury curve's bull flattening, afforded issuers very low negative arbitrage (i.e., the difference between escrow earnings and borrowing rates until the call date) that can be dwarfed by the cost savings of replacing 5 percent coupons on tax-exempt bonds with borrowing rates near 3 percent.

The momentum of this supply phenomenon has broadened the municipal demand base and supported a bullish backdrop for the tax-exempt market, particularly for bonds with shorter call dates. The series of favorable technical factors throughout the year has helped push credit spreads to the tightest levels in the past decade. Meanwhile, state and local governments' debt and unfunded pension liabilities has remained above 400 percent of tax revenues since the last recession (see chart, bottom right). We believe this cognitive dissonance provides an opportunity to forgo very marginal carry in order to be selective and move up significantly in credit quality.

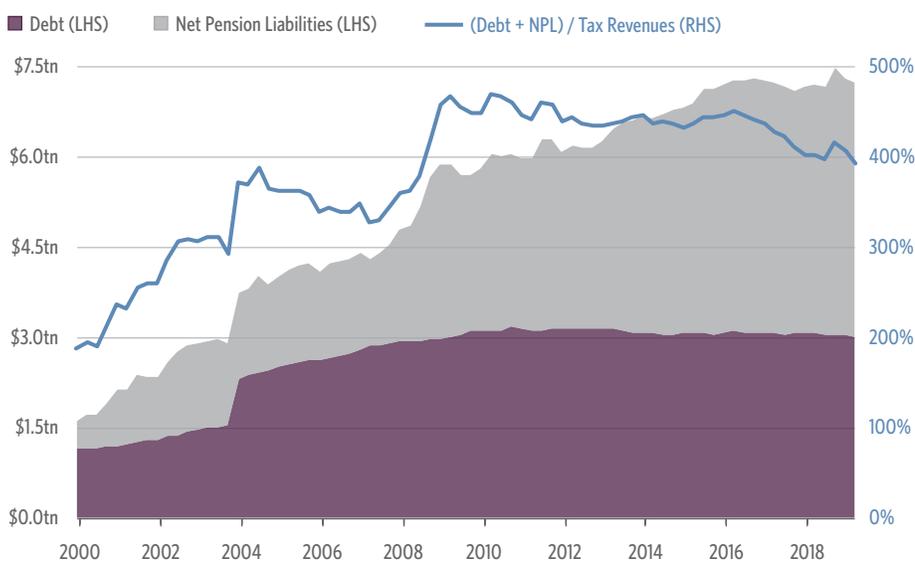
Taxable Muni Bond Issuance Is on Pace to Surpass \$60 Billion



Source: Guggenheim Investments, BondBuyer, SIFMA. Data as of 11.30.2019.

Taxable new issuance, which surpassed \$50 billion for the first time since the Build America Bonds program in 2009–2010, boosted overall supply.

Unfunded Pension Liabilities Outweigh Tax Revenues by 400%



Source: Guggenheim Investments, U.S. Bureau of Economic Analysis, Federal Reserve. Data as of 3.31.2019.

State and local governments' debt and unfunded pension liabilities has remained above 400 percent of tax revenues since the last recession.

Investing involves risk. In general, the value of fixed-income securities fall when interest rates rise. High-yield securities present more liquidity and credit risk than investment grade bonds and may be subject to greater volatility. Asset-backed securities, including mortgage-backed securities, may have structures that make their reaction to interest rates and other factors difficult to predict, making their prices volatile and they are subject to liquidity risk. Investments in floating rate senior secured syndicated bank loans and other floating rate securities involve special types of risks, including credit risk, interest rate risk, liquidity risk and prepayment risk. Guggenheim Investments represents the following affiliated investment management businesses of Guggenheim Partners, LLC: Guggenheim Partners Investment Management, LLC, Security Investors, LLC, Guggenheim Funds Investment Advisors, LLC, Guggenheim Funds Distributors, LLC, GS GAMMA Advisors, LLC, Guggenheim Partners Europe Limited and Guggenheim Partners India Management. ©2019, Guggenheim Partners, LLC. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission of Guggenheim Partners, LLC.