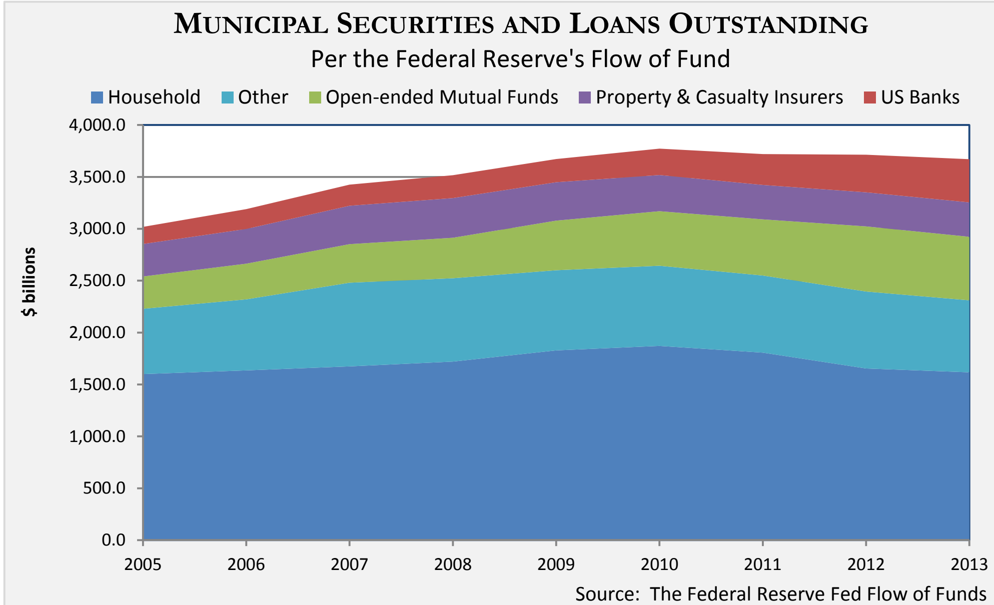
HEADLINE NEWS: MUNI MARKET SHRINKING



- According to the Federal Reserve's recent Flow of Funds release, the municipal market continued its multi-year pattern of shrinking, as total municipal securities at the end of 2013 declined 1.2% year-over-year to $3.67 trillion. This marks the third consecutive year of declines and the lowest level since the end of 2009. The amount of outstanding municipal securities reduces as new money issues fail to keep pace with redemptions and maturing bonds, essentially creating "net-negative supply." A number of market observers predict the declining trend to continue through 2014, as issuers are reluctant to return to pre-recession borrowing levels.
- From a holder perspective, we see a number of small trends appearing, but not a significant change in the ownership composition. While municipal securities continue to be largely held by households, a number of other sectors have increased their interest in the market. U.S. banks increased their holdings by 14.7% in 2013 and now hold 11.3% of the market compared to only 6.1% in 2009. Property and casualty insurers increased their holdings by 1.4%, the first increase in five years. Households, which is largely a catch-all sector, now represents 44.1% of municipal investors compared to 53.0% in 2005.
- On Friday, the market was surprised by a few numbers, led by Nonfarm Payrolls coming in at 175k versus the expected 149k. Average Hourly Earnings came in slightly above expectations. Notably, part-time jobs were reduced by 210k. Further, the unemployment rate ticked up to 6.7% from 6.6%, while the participation rate remained at 63%. Yields jumped up on the news, but the data is not consistent enough for the Fed to change their forecast.

MARKET UPDATE: MARKET DIGESTING INCREASED SUPPLY

- Municipal supply soared to over $10 billion this week making it only the 5th week since 2009 with issuance over $10 billion. The calendar is led by 3 large deals: $3 billion Puerto Rico GOs (Ba2/BB+/BB), $1.6 billion California GOs (A1/A/A) and $1.35 billion Houston, TX Utility (NR/AA/AA) bonds. Interestingly, the Puerto Rico deal will draw primarily non-traditional municipal buyers. Adding to the municipal demand, fund flows saw the largest inflows in over a year at $1.2 billion. As we approach the April 15th tax deadline, we may see a reduction in flows. The Municipal yield curve weakened at the end of last week, with the most pronounced adjustment on Friday, after the employment report surprised the market. The 5Yr widened 8bps, while the 10Yr and beyond widened 12bps.
- Coming into last week, the market was expecting about $25 billion in Investment Grade Corporate new issuance. However, those expectations were met and then some as a total of about $54.25 billion was absorbed. These deals have been going very well as most of them are getting orders for more bonds than are actually available. This "oversubscription" is zeroing out the normal new issue concession, as deals are often priced higher than where they were originally advertised and trade up significantly in secondary trading. One of the largest and most notable deals of the week was the $4 billion that Gilead Sciences (GILD Baa1, A-, BBB+) brought on 3/4/14. Spreads remain stable as credit spreads were slightly tighter on the week.

FIXED INCOME INDEX RETURNS

	MTD 3/7/14	YTD 3/7/14
Barclays 3Yr	0.01	0.69
Barclays 5Yr	-0.21	1.65
Barclays 7Yr	-0.28	2.46
Barclays MM Short 1-5Yr	-0.08	0.76
Barclays MM 1-10Yr	-0.30	1.79
ML US Gov/Corp 1-10 Yr	-0.40	0.86

Source: IDC

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