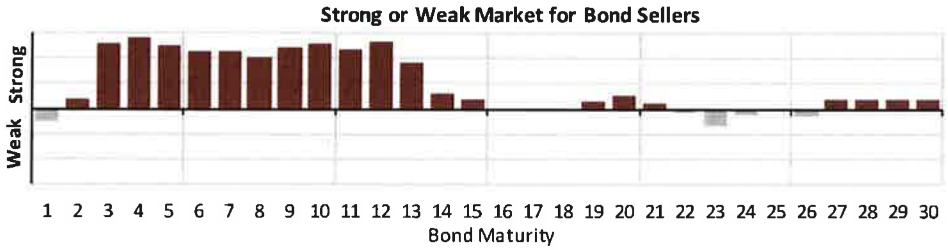
MMA Independent and Data Driven

FirstSouthwest

MUNICIPAL MARKET JOURNAL



MMA 5% AAA Benchmark

	1/8/2016	*1/1/2016*	*Change*
2-yr	0.66%	0.69%	-3
5-yr	1.16%	1.28%	-12
10-yr	1.88%	1.99%	-11
30-yr	2.81%	2.94%	-13

January municipal strength in the municipal bond market has been seasonally consistent, assisting issuers who seek to raise capital at the year's start.

MARKET UPDATE

The rally to start 2016 has already consumed the bulk of potential gains for 1Q—based on the historical relationship of the first 2 weeks relative to the entire quarter.

HIGHLIGHTS

- Although US economic data continued to provide a mixed message on growth, slowing Chinese consumer/industrial demand and a collapse in global commodity prices created worries around the globe, stressing US equity indices and sending bond yields sharply lower.
- Seasonal demand expectations—strength in tax-exempts for the first half of January (**Figure 1**)—contributed to municipal yields falling by 10-13 bps across a flatter curve.
- Further, more Street strategists began to forecast against the odds of dramatically higher interest rates this year. The outlook contributed to firms adding duration and to demand for the 5yr UST.
- Most municipal market participants, particularly investors, have waited years for yields to rise. However, now that the Fed seems committed to higher rates in 2016, it will be a challenge to rebuild retail demand for low interest bonds, never mind long premium 3% coupons or rich BBB odd lots in the near-term.
- In other words, last week's rally notwithstanding, **MMA** expects that the Fed-fueled potential for higher yields by 2H16 will quickly short circuit investor participation in the market rally. Look for cross market yield ratios to begin rising again.
- Last week the primary calendar was light and new issues were oversubscribed and re-priced to lower yields. Secondary transactions were also robust, an indication of strong customer interest, fund inflows, **Figure 2**, and improved issuer liquidity. Such a context has generated an increase in the forward calendar, **Figure 3**.
- Bids-wanted volume did reach $1.26B on Thursday the highest daily level in over 14 months, as investors sought to fill the primary supply void and capture high prices to boost their portfolio returns. Higher secondary selling pressure can act to challenge new pricing and deal distribution for the issuer and underwriter.
- This week, the Chicago IL and IL GO deals are apt to draw market attention, the latter coming competitively on Thursday. Despite these issuers' negative headlines, credit spreads have remained tight as investors have continued to pursue yield.

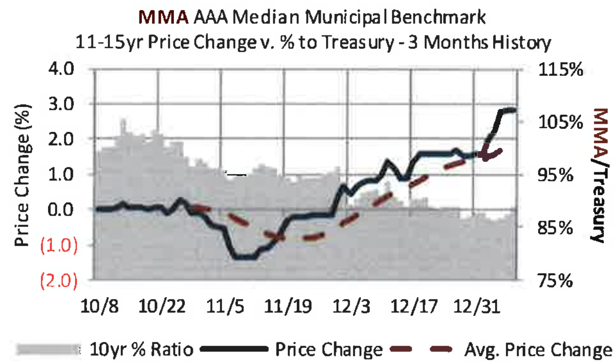


Figure 1: Municipal price momentum constructive since November.

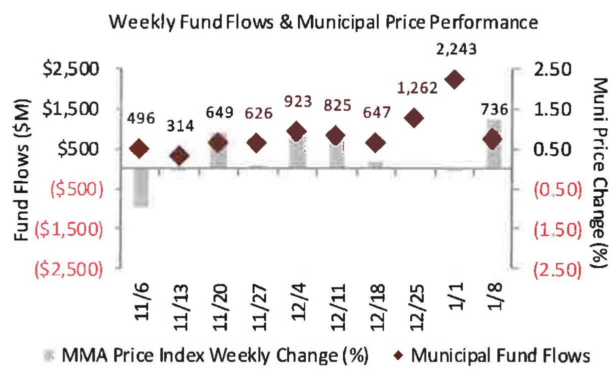


Figure 2: Positive price movement helped by mutual fund demand.

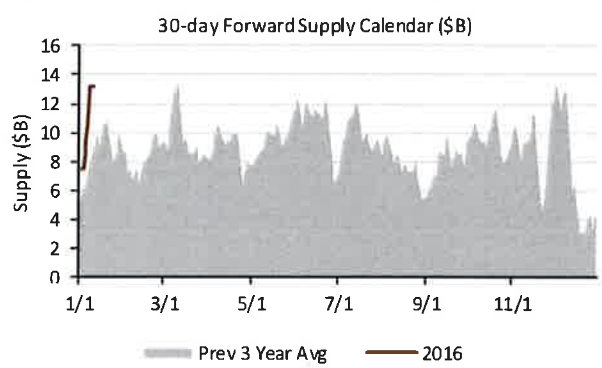


Figure 3: Municipal issuance has risen above average—a sellers market.

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MARKET CONTEXT AND WASHINGTON RESPONSE TO PUERTO RICO CRISIS

MARKET DYNAMICS TO REMAIN FAVORABLE FOR ISSUERS: The municipal market shrunk 1% in 2015 in terms of non-refunded, non-derivative par outstanding. As investors enter 2016, they should anticipate a tighter supply of high-grade, safe sector municipal securities which will likely mean compressed spreads even if the Fed continues to raise rates. Issuers, particularly those in the high yield sector—below investment grade and unrated credits—will reasonably continue to benefit from supply and yield hungry investors. Under these conditions in 2015 the volume of high yield debt outstanding grew 9% ($29B) to $350B. And note how several of the largest state debt markets contracted faster than the US municipal bond market as a whole last year.California, Florida, and New Jersey debt contracting faster than US: Of the 20 largest state debt markets, nine shrank more quickly than the national average last year, led by CA (2.0%), FL (2.4%), and NJ (1.7%). This means the $517B universe of debt issued by CA issuers has shrunk by $10.9B in a year and, it follows, that CA spreads have a structural tightening bias versus the nation, all else being equal. The $116B NJ debt market fell by $2.1B during last year, also helping NJ bonds tend to outperformance. Among all state debt markets, the fastest drop was in RI (down a stunning 13.4%), NH (-11.4%), and WY (-9.7%). By contrast, state debt growth is noted in WA (+2.5%), MD (+2.1%), CT (+4.3%), SC (+1.2%), AL (+0.5%), and several smaller states.

PUERTO RICO AND WASHINGTON: In **MMA's** opinion, heavy media coverage of PR's financial crisis, plus the commencement of post-default litigation by the bond insurers, are together raising the odds of near-term (1Q) Federal legislative action on Puerto Rico. This may well take the form of at least conditional access to (super) bankruptcy, reasonably in tandem with a more invasive financial control mechanism. Indirect support for PR bankruptcy by several major conservative thought leaders in American Enterprise Institute and the *Wall Street Journal's* editorial page, a lack of discussion on alternative restructuring ideas, and the perceived importance of appeasing Puerto Rican voters in the tightly-contested Florida electorate all imply the potential for a bipartisan agreement in some form. Still it is hard to say that the odds of a new bankruptcy law exceed 50%: principal Republicans in Congress clearly remain opposed to the concept. And, in its opaque and curious handling of 4Q15 revenue clawbacks ahead of 1/1/16 debt payments, the commonwealth itself has only bolstered arguments favoring a strong and professional Federal control board.

IMPACTFUL BOND DEALS AND ASSOCIATED TRADING

Below are four new primary deals that have impacted the market recently with associated secondary trading dynamics:

South Carolina Public Service Authority

1/7: **Bank of America Merrill Lynch** priced $527M revenue obligation bonds for the **South Carolina Public Service Authority**; A1/AA-/A+; callable at par in 6/1/2026, except bonds in 2047 & 2049 which are callable at par in 12/1/2020:

Pricing Notes: Bonds were bumped in the short to intermediate range with the largest adjustments up front (12 bps on 5-year bond).

Maturity	Coupon	Yield	+/- AAA 5%
2026	5.00	2.27	+39
2036	5.00	3.08	+49
2049	4.00	3.90	NA

Secondary Trading: 5s of 2037 traded 3 bps weaker Monday (1/11).

Public Finance Authority, WI

1/7: **JPMorgan Securities LLC** priced $327M KU Campus Development Corporation lease development revenue bonds for the **Public Finance Authority, WI**; Aa2/NR/NR; callable at par in 3/1/2026:

Pricing Notes: Bonds 10-years and in were bumped while bonds 20-years and out were cut as much as 6 basis points.

Maturity	Coupon	Yield	+/- AAA 5%
2018	4.00	0.89	+23
2026	5.00	2.19	+31
2046	5.00	3.31	+49

Secondary Trading: At originals as of publication.

New Jersey Health Care Facilities Financing Authority

1/6: **Wells Fargo Securities** priced and re-priced $191M Princeton HealthCare System Issue bonds for the **New Jersey Health Care Facilities Financing Authority**; Baa2/NR/BBB; callable at par in 7/1/2026 :

Pricing Notes: Strong demand for lower rated health care as bonds were bumped 8 to 15 basis points across the curve.

Maturity	Coupon	Yield	+/- AAA 5%
2021	5.00	1.86	+64
2026	5.00	2.75	+82
2039	5.00	3.41	+65

Secondary Trading: 5s of 2039 broke 8 bps firmer on Thursday.

Massachusetts School Building Authority

1/6: The **Massachusetts School Building Authority** sold $150M senior dedicated sales tax bonds to **Wells Fargo Securities**; Aa2/AA+/AA+; callable at par in 11/15/2025 :

Pricing Notes: We understand the deal was bid aggressively amid a relatively light new issue slate and elevated demand.

Maturity	Coupon	Yield	+/- AAA 5%
2020	3.25	1.23	-15
2025	5.00	2.21	-6
2035	3.50	3.58	+54

Secondary Trading: 5s of 2032 broke 2 bps better on Thursday.