Summary

- Ten-year Treasury yields rallied 13 basis points (bps) in response to several weak economic data releases.
- The liquidity freeze impacting the bond market continues to thaw.
- Markets are differentiating between credits as high quality, non-COVID exposure issuers are rewarded.
- Rating agencies are downgrading bonds at a rapid pace to avoid falling behind the curve.

Tax-Exempt

- The tax-exempt bond market rallied on Friday after three straight days of selling pressure. Yields in the 1.50%-2.00% range for high quality, intermediate-term bonds attracted crossover buyers to the relative value.
- Mutual funds and ETFs continue to experience outflows which rippled through the market for most of the week, resulting in a -0.74% decline for the ICE BofAML 1-10 year Municipal Index.
- Total new issuance was a mere $2.2 billion with only $4.4 billion expected for this holiday-shortened week. However, a $10+ billion backlog of new issues is building on the sidelines waiting for market conditions to improve.
- Overall market liquidity has improved, however there are still signs of stress. The number of bidders is below normal and the wide range of prices suggests the price discovery process is ongoing.
- The SIFMA Municipal Swap Index reset sharply lower at 1.83%, reflecting increasing demand from money market investors.
- Although we expect a sharp decline in general fund balances, states were in a strong financial position to handle this downturn. Solid liquidity levels, the infusion of federal assistance, and access to capital markets will help mitigate credit deterioration during this temporary, albeit significant, business disruption.
- New York's Metropolitan Transit Authority (MTA) bonds lagged after it announced that its chairman was diagnosed with COVID-19 and that the authority plans to price $800 million in new bonds. Some good news, however, is that in addition to the $4 billion it will receive from the federal stimulus package, state legislators are considering a bill that would allow MTA to borrow to cover operating costs until 2022. Odds of the bill passing are fairly good at this point.

Taxable

- Investment grade corporate spreads rallied early in the week (demand was muted following the previous week's frenzy) before turning more negative as supply continued to flood the market and issuers offered substantial concessions to get deals done. Investment grade OAS ended the week just one basis point tighter to 283 bps. High yield saw modest spread widening, ending the week at 943 bps.
- Credit curves continued to steepen with higher quality, short dated bonds outperforming and longer dated, lower quality lagging.
- Many single-A and above industrials like Microsoft and Wal-Mart are now trading back in double digits for the first time in several weeks.
- Energy saw better activity as oil rallied more than 40% off the lows on news of coordinated global efforts among oil producers to stem the flow of the commodity in a demand-challenged economy.
- For the second straight week we broke the weekly record for investment grade supply with $118 billion issued including $19 billion from T-Mobile to finance its acquisition of Sprint. New issue concessions weakened markedly this week as the supply was dominated by lower quality companies, including $61.5 billion in BBB industrials.
- After being closed for most of the past month, the high yield new issue market re-opened this week with a handful of deals including Carnival Corporation's $4 billion three-year secured deal.
- The ratings agencies continued to downgrade issuers with Hyatt, Tapestry, Exxon and Oracle among the list last week. Fitch put nearly all European banks on watch for downgrade and/or downgraded their subordinated debt. Moody's put all integrated oil companies on negative outlook.

Sources: Bloomberg, Barclays Capital, Bank of America Merrill Lynch. Please see page 2 for important disclosures and definitions.

Index Definitions

The ICE Bank Of America Merrill Lynch 1-10 Year Municipal Index is a component of the ICE BofA Merrill Lynch US Municipal Securities Index including all securities with a remaining term to final maturity less than 10 years. The Index tracks the performance of U.S. dollar denominated investment grade tax-exempt debt publicly issued by U.S. states and territories, and their political subdivisions, in the U.S. domestic market. Qualifying securities must have at least one year remaining term to final maturity, a fixed coupon schedule and an investment grade rating (based on an average of Moody's, S&P, and Fitch).

The Securities Industry and Financial Markets Association (SIFMA) Municipal Swap Index is a 7-day high-grade market index comprised of tax-exempt Variable Rate Demand Obligations (VRDOs) with certain characteristics. The Index is calculated and published by Bloomberg. The Index is overseen by SIFMA's Municipal Swap Index Committee.

Disclosures