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US Municipals Slide with Treasuries

By Rebecca Smith | 01-19-2001

New York - Jan 19, 2001 Municipal bonds were generally lower in sympathy with softer US Treasuries Friday and as the supply calendar, which had been barren in early January, continued to build.

Yields on long maturity new muni bonds sold during the week generally topped 5% after the dearth of supply earlier this month had pushed those yields to sub-5% levels last week.

The higher prices last week led to sticker shock among investors, and while some said that's in part been alleviated by a bettor flow of new deals of late, others say higher prices are still an issue.

Clark Stamper, a portfolio manager for Evergreen Funds' High Income Municipal Bond Fund, said there hasn't been enough pickup in supply to Account for an increase in money flow into muni funds.

"The new issues are very rich," he said. "I'm not buying many new issues."

There are a few healthy-sized offerings on the calendar next week, including $295 million general obligation bonds for Washington and $171 million GOs for Washington both to be sold via competitive bid Tuesday.

In addition, Tampa Bay, Fla. will sell approximately $320 million utility system refunding and improvement revenue bonds through Raymond James, the Arizona Transportation Board will sell $150 million revenue bonds via Salomon Smith Barney and the City and County of Denver will sell $165.5 million revenue bonds through Muriel Siebert & Co.

"Supply is picking up," said one New York dealer. But "I still think the market needs a benchmark type deal, a sizable term issue to get some trading off of."

He said munis fell in quiet trade, following Treasuries lower Friday.

Treasuries slipped and bonds underperformed short coupon amid heightened expectations for aggressive rate cuts from the Federal Reserve. Fed policy makers meet Jan 30-31 and late in the day January federal funds futures implied about an 88% chance of a 50 basis point cut at the meeting.

Stamper said the Treasury bond's initial slide after the Federal Reserve's 50-basis point inter-meeting rate cut earlier this month troubled him enough that he's favoring a shorter duration, less interest rate risk portfolio.

He's worried about the possibility of more than a fleeting recession in the US economy. Stamper noted that the junk bond taxable market is already trading at recessionary levels, which he sees as a sign a more pronounced slowdown than most are banking on may indeed be on the way.

While the Fed is likely to continue to cut rates, benefiting short-term securities, "I'm concerned that long rates could continue to rise," he said.

Though he's steering clear of many of the new issues, Stamper does see some sectors of the outstanding muni market as attractive, including the troubled California utilities debt.

"The secured bonds (currently trading) in the mid 70's are fairly attractive," he said. "They're probably money good."

The rating agencies knocked the debt of Southern California Edison and Pacific Gas & Electric to junk status after missed coupon payments and as the crisis in California heightened this week.

Stamper said if the utilities slip into bankruptcy, their debt's prices will probably slip further, thus making the bonds "an even better buy."

But "the unsecured bonds are pretty risky," he added.

He's also looking at industrial revenue bonds, in particular those of USG Corp., a maker of wallboard which has suffered from asbestos litigation.

Stamper Poor's last week said it may lower USG's BBB corporate credit rating and cited the risk from asbestos litigation.

Stamper pointed out that the USG bonds have been yielding 9-10% and "look pretty attractive."

At 1635 ET, the 30-year Treasury bond was down 1 5/32 to yield 5.551%, while the 10-year note was down 13/32 to yield 5.17%.

In debt-futures trading at the Chicago Board of Trade, the March municipal-over-bond spread was down 14 at 25 ticks at 1500 ET. The March municipal contract was down 21/32 at 104 14/32, while the March US Treasury bond contract was trading down 1 1/32, at 103 23/32.

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