Stamper Capital & Investments, Inc.

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Muni Investors Should Not Limit Themselves to New Issue Bonds

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Many people tend to believe that investors must buy a bond when it is first issued and hold onto that bond all the way until maturity. Just because a state government may put an ad in the paper or on the radio announcing they are now selling State General Obligation bonds, that does not mean this is the only time an investor can buy these bonds. Investors can buy and sell bonds in what is called the "secondary" market, where people who have already purchased a bond when it was newly issued can sell to other investors before maturity. In the secondary market buyers can find a wide variety of different bonds at more favorable prices than they could when the bonds were originally issued. In fact, the secondary market is where investors who are willing to put in the time and legwork and really know what they are doing can make the best returns and manage risk simultaneously. In this article, Stamper Capital & Investments, Inc. will explain some of the differences of trading municipal bonds in the secondary market versus buying newly issued municipal bonds.

A major difference between a new issue market and the secondary market is pricing. When a bond is newly issued, all buyers pay the same price, set by the people selling the bonds. The new issue price is usually higher than it would be in the secondary market because the sellers need to pay for all the marketing costs for that new issue (those ads in the paper and on the radio announcing the bonds are for sale don't come for free, after all). In the secondary market, buyers or their brokers can bid the price they are willing to pay for a bond, and the seller can agree whether to accept that price. The result is that there are often wide disparities in prices of the same bond trading in the secondary. The ability to buy an investment at a lower price is also a way to help reduce risk. Buying the same bond at a lower price in the secondary vs. at a higher price as a new issue should give an investor superior yield and better risk/return performance. Of course, the investor needs to know what they are doing to make sure they are getting a bargain price.

The secondary market also offers more to choose from than if an investor was only considering new issues. Because muni bonds are issued by political bodies in general, the types of new bonds being issued tend to reflect the political/economic trend of the moment – during the housing bubble, economic development authorities could not issue housing bonds fast enough, but today education bonds are more prevalent, as well as revenue or bond anticipation notes to finance local government operating costs. In the secondary market, investors can buy all of these, plus other types of bonds that may have been popular years ago but are unusual today such as Pollution Control bonds or Toll Road/Highway Revenue bonds, some at deep discounts from the original new issue prices. In addition, there have been periods where few new bond deals were issued because lenders had little appetite for risk, or another type of bond had gained popularity. For example, in 2009 the government was promoting Build America Bonds – a taxable bond program that subsidized part of the interest for the borrower – and almost every new muni issuance was a BAB. They were so popular that few tax-free muni bonds were being issued at the time, so there was hardly anything for new issue tax-free investors to buy. While this was going on, investors in the secondary market were still trading as usual.

One of the best ways for smart investors to reduce risk is to buy what are known as "cushion bonds" - callable bonds that are priced in such a way that even if bonds are called, there is still a little room to come out ahead. And if they are not called, the cushion bonds outperform the noncallable bonds if held to maturity. Often a cushion bond can be purchased so that even if there were some volatility in the market, the bond would have a little wiggle room for comfort – hence the 'cushion'. In the new issue market, most bonds are not callable for many years, so if they have any sort of cushion, it is usually relatively small and not anywhere near what they could have bought in the secondary market (the pros call these new issue cushion bonds 'sucker bonds'). The secondary market offers much better opportunities to dig up cushion bonds with much larger cushions.

Availability of information is another difference between new issue bonds and those in the secondary market. Unless a new issue is from a very large and well known borrower like a state, research information may be limited to the marketing materials the seller is producing for the offering. This usually includes a preliminary official statement and the current audited financial statement. In the secondary market, these are usually available, but investors can also find older financial statements, trustee notices, disclosure documents, and a history of call actions, default notices, and trade prices. The more information an investor can research, the more likely they can accurately bid. Also, in the case there is less information available, investors can often make purchases at lower prices.

Investment goals are an important factor when considering whether to buy a newly issued bond or one in the secondary market. For well informed or experienced investors, new issues might offer an opportunity for a short term flip to make a quick profit, but buying in the secondary could be better for a buy-and-hold strategy. Of course, this requires a synthesis of all the points mentioned earlier, expertise & experience, and active portfolio management.

In the world of municipal bonds, the real bargains are to be found by experienced investors who are willing to put in time researching the secondary market. Stamper Capital & Investments, Inc. has been in the business of managing high net worth accounts in the muni market for over twenty years, and has a great track record to show for it – see the Performance section of our website www.risk-adjusted.com for more details. Our Portfolio Manager, B. Clark Stamper uses his expertise and active management style in the secondary muni market to help clients gain upside potential while maintaining downside protection. High Net Worth Investors who would like to take advantage of the great opportunities the secondary municipal bond market has to offer should call our office today at 949-673-5787, and ask for a complimentary portfolio review by our portfolio manager, B. Clark Stamper.

Stamper Capital & Investments has been positioning our clients over the past several years in preparation of what we are forecasting. If we are right, the past three years will seem like a walk in the park compared to what is coming. We intend our clients to not only just 'survive' what is to come, but to be in a position to make once-in-a-lifetime investments at fire-sale prices. If you are interested in discussing our forecast further or would like to inquire about privately managed municipal bond accounts, please contact Stamper Capital & Investments at (949) 673-5787 or email us at **separatelymanagedaccounts@risk-adjusted.com.**

Stamper Capital & Investments, Inc. provides portfolio management services exclusively for institutional and high net worth accounts and does not sell the mutual funds for which it is or was a sub-Advisor. Also, please note: purchasers of mutual funds must receive a copy of a particular mutual fund's prospectus before a purchase is made.

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