

August 2017

## Municipal Market Update:

# Understanding Muni Market Liquidity

By the Standish Municipal Bond Team

### Executive Summary

- ▶ The US municipal market is large and robust, historically driving over three quarters of capital investment in America's infrastructure.
- ▶ A broad and diverse base of state and local issuers finance much of the country's transportation system, social infrastructure, water resources, and energy generation and transmission.
- ▶ Voters, governors, legislators and the president acknowledge the urgency to invest in America's infrastructure.
- ▶ It is estimated that \$4.6 trillion must be invested in US infrastructure over the next eight years.
- ▶ Orderly operation and liquidity of the municipal market is augmented by growing demand from overseas investors.
- ▶ Well-resourced institutional investors can exploit mispriced liquidity premiums, especially during episodic retail-driven dislocations.

### Diverse and Fragmented Market

Annualized turnover of the municipal market approximates that of US corporate bonds.

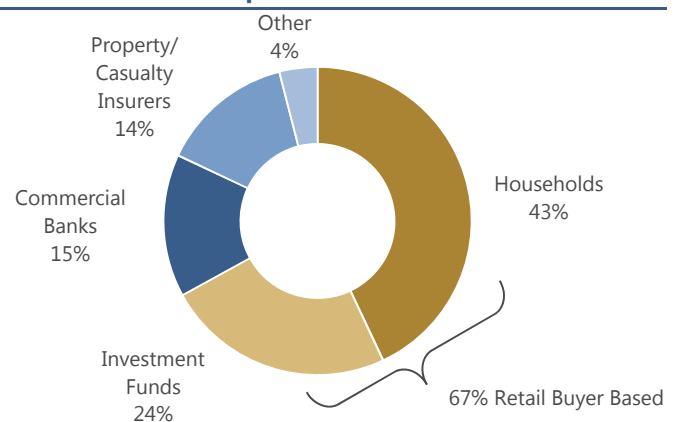
### Munis vs. Corporates and UST Characteristics

	Municipals	Corporates	Treasuries
Amount Outstanding (\$bn)	3,831	8,552	13,348
Average Daily Volume (\$bn)	11	30	503
# of CUSIPS	950,000	20,000	900
Annualized Turnover	0.7x	0.9x	9.2x

Source: SIFMA, Bloomberg December 14, 2016

Unlike the corporate market, the issuer community and buyer base of the municipal market is fragmented, creating inefficiency and opportunity for investors. There are over 50,000 issuers in the nearly \$4 trillion US municipal market and almost half of the investors are individuals holding bonds bought directly from a broker; thus a large portion of the market is 'put away' without further transaction. An additional one-quarter of the municipal market is concentrated in retail-oriented mutual funds.

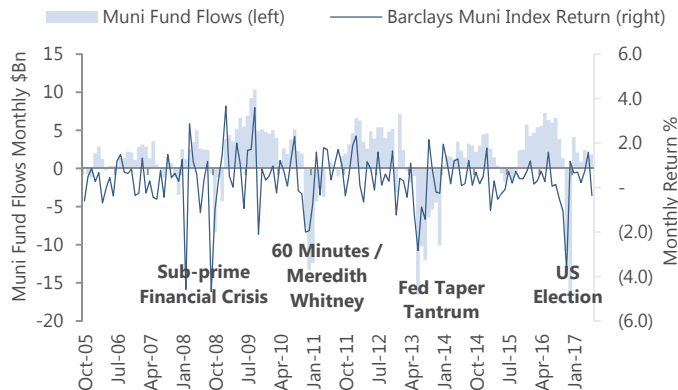
### Holder of U.S. Municipal Bonds - \$3.8 Trillion



Source: Federal Reserve as March 31, 2017

When retail investors engage in abrupt—usually fear-based—selling of their fixed income investments, the otherwise orderly and liquid municipal market is vulnerable to infrequent and short-lived bouts of strained liquidity. Recent examples include the post-US election ‘Trump Bump’ and 2013 ‘Taper Tantrum.’

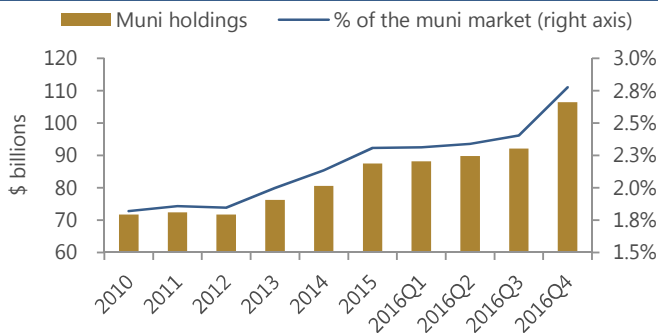
### Muni Market Sell-offs are Technically Driven



Source: Investment Company Institute. Bloomberg Barclays Muni Index as of June 30, 2017

Particularly if financial regulations are loosened, professional investors can be increasingly active in making markets, especially during periods of volatility. Additionally, global investors are increasingly attracted to the quality, stability, diversification and yield offered by US municipals, introducing a rapidly growing source of demand.

### Global Investment Is Rapidly Rising

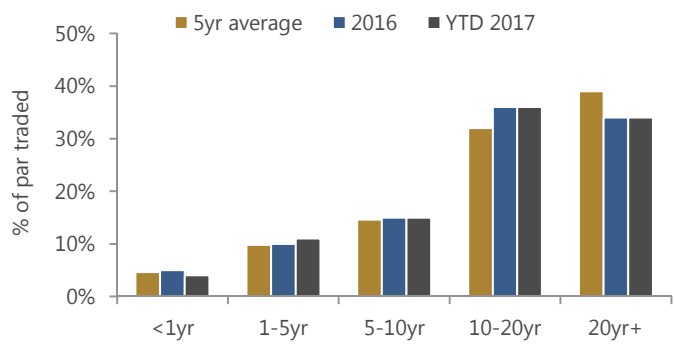


Source: Federal Reserve Board Flow of Funds; Standish as of March 9, 2017 report

### Navigating Municipal Market Liquidity

Much of the municipal market trading volume occurs where yields are attractive, in longer maturities, and where institutional buyers are active, in larger blocks and bigger issues.

### The Percentage of Par Traded Increases with Maturity



Source: Citi Research as of February 28, 2017

### Average Bid/Ask Spreads for Municipal Bond Trades

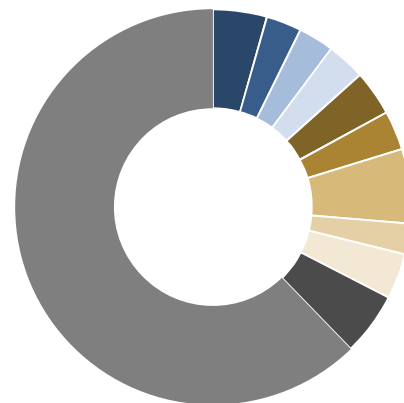
Rating	Total Spread (15 year maturity)	
	Institutional (\$1million)	Retail (\$100K)
AAA	0.16%	0.95%
AA	0.16%	1.00%
A	0.16%	1.05%
BBB	0.18%	1.20%
Non-Investment Grade	0.47%	1.85%

Source: Bloomberg as of July 31, 2017

Standish’s centralized trading desk utilizes over one hundred brokerage firms, including large Wall Street wire houses and smaller regional and niche firms, in order to source the most attractive offerings and deliver ongoing best execution.

### Fragmented Buy-Side Sponsorship

- Raymond James
- J P Morgan Securities LLC
- Bank of America Merrill Lynch
- Citi
- Morgan Stanley
- RBC Capital Markets
- Ramirez & Co Inc
- Wells Fargo & Co
- Siebert Cisneros Shank & Co LLC
- Stifel Nicolaus & Co Inc
- Other



Source: Bond Buyer by number of issuers during first half 2017 as of June 30, 2017

This commentary is provided for general information only and should not be construed as investment advice or a recommendation. You should consult with your advisor to determine whether any particular investment strategy is appropriate. These views are current as of the date of this communication and are subject to change as economic and market conditions dictate. Though these views may be informed by information from publicly available sources that we believe to be accurate, we can make no representation as to the accuracy of such sources nor the completeness of such information. Please contact Standish for current information about our views of the economy and the markets. Portfolio composition is subject to change, and past performance is no indication of future performance.

BNY Mellon is one of the world’s leading asset management organizations, encompassing BNY Mellon’s affiliated investment management firms, wealth management services and global distribution companies. BNY Mellon is the corporate brand for The Bank of New York Mellon Corporation. Standish is a registered investment adviser and BNY Mellon subsidiary.