BALLENTINE
PARTNERS

October 26, 2022

Munificent Munis: Muni Bonds Look Attractive and Rainy Day Funds Are Overflowing

Pete Chiappinelli, CFA, CAIA, Deputy Chief Investment Officer

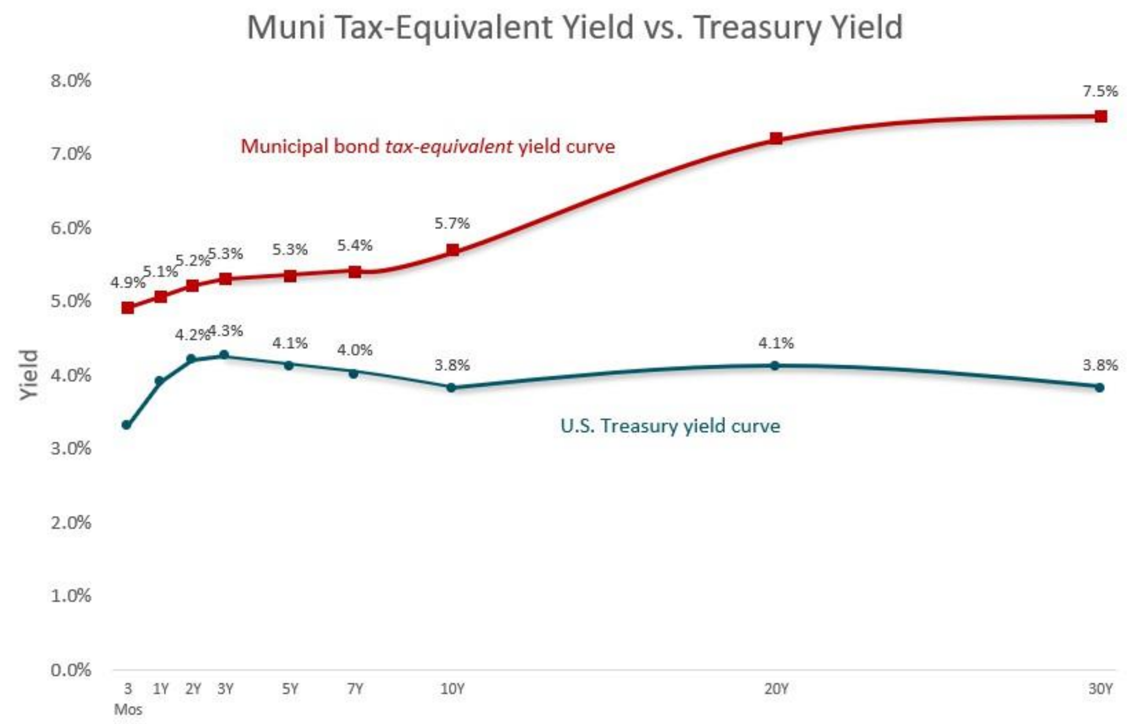
"Be prepared for the worst but hope for the best."

- Benjamin Disraeli, twice Prime Minister of the U.K.

As U.K. political turmoil swirled this past week and weekend, there was chatter about Boris Johnson possibly returning as Prime Minister. While that might have struck many as odd, given that he had been ousted only six weeks prior, it would not have been without precedent. Benjamin Disraeli, pictured above, actually served twice as Prime Minister in the 1860s and 1870s. Known for his silver tongue and quick wit, he remains one of history's eminently quotable figures, with such wry beauties as: "England is governed not by logic but by Parliament", and "There are three kinds of lies: lies, damned lies, and statistics" (often and erroneously attributed to Mark Twain).

We thought of him this week, as well, because prior to his two stints as Prime Minister, he served as The Chancellor of the Exchequer, which is the government's chief financial minister, responsible for raising revenue through taxation and for controlling public spending. The quote above, certainly sage during his time, is meaningful today when we look at the finances of local governments around the U.S., who appear to have been listening to Disraeli's ancient but wise counsel.

Getting paid quite nicely in municipal bonds, relative to Treasuries



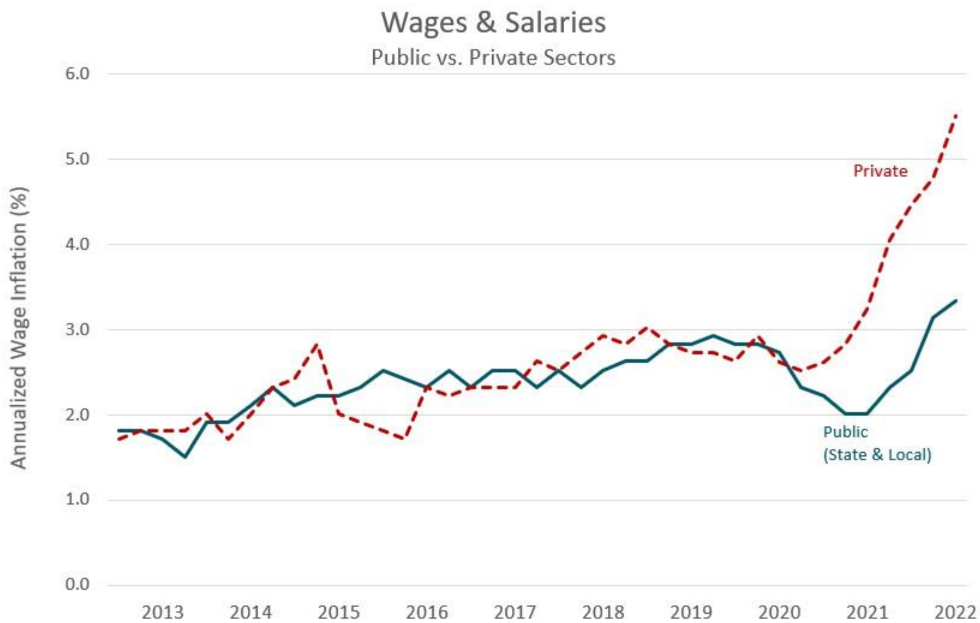
Source: J.P. Morgan Asset Management, Bloomberg. Yield curve as of October 17, 2022

See below. The tax-equivalent yield curve for municipal bonds is looking steep and inviting relative to the U.S. Treasury Yield curve, which is flat to inverted. As a high tax-bracket investor, you could be staring at investment-grade municipal bonds which are paying you a tax-equivalent yield in the 7+%-plus range. If you are willing to assume more credit risk by venturing into high yield municipals, the taxable-equivalent yields are even more compelling.

Should we be lured by such munificent payouts? "That's credit risk, and clearly the risk of a recession is rising," you might say. And that would be fair. But this is where the story gets interesting, because the state of state finances appears rock-solid, at least for the foreseeable future. First, tax revenues are up due to inflated incomes (in those states with an income tax) inflated sales taxes, and rising property tax proceeds.

Wages and Salary Growth for Public Sector More Subdued

BALLENTINE PARTNERS



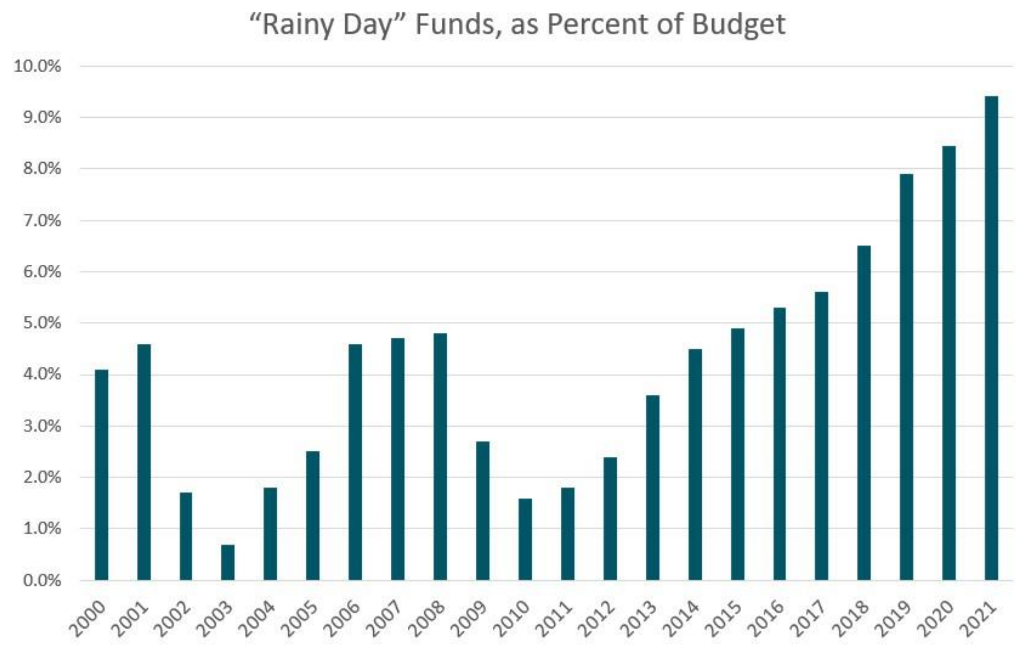
Source: Bureau of Labor Statistics, Ballentine Partners. Data through June 30, 2022.

(Remember, home prices are up materially year-over-year, and even if prices fall, tax appraisals will lag).

Second, costs have not kept pace with this rising revenue. Interest expense on municipal debt is low and manageable because so many municipalities locked in low interest rates during the last ten years. Also, see the chart below, which shows that employee labor costs, a major component of their budgets, have not risen nearly as fast as wages in the private sector.

Third, the largesse from the Federal government during the COVID-19 crisis certainly put their finances on sturdier ground.

The net-net is that states and local governments are not only in pretty good shape, but they have been squirreling monies away to prepare for what some are calling the “inevitable.” If a recession were to hit, these local authorities have been preparing for years in something called their “rainy day” funds. As we stare at the latest figures, these municipalities have the highest rainy-day reserves in the history of tracking such data. In the words of Benjamin Disraeli, local authorities have done a decent job of hoping for the best while preparing for the worst. For this reason, we remain constructive on municipal bonds.



Source: Ballentine. All data comes from "The Fiscal Survey of the States" reports, which are based on the National Association of State Budget Officers' semiannual surveys of state budget officers; Pew Charitable Trusts.

Pete Chiappinelli, CFA, CAIA, Deputy Chief Investment Officer

Pete is Deputy Chief Investment Officer at the firm. He is focused primarily on Asset Allocation in setting strategic direction for client portfolios. Pete has 30 years of experience in research, investment strategy, and thought leadership regarding the management of multi-asset class portfolios, inclusive of equities, fixed income, and alternatives. His work has been featured in leading financial publications such as *The Wall Street Journal*, *The New York Times*, *Barron's*, and others in Canada, Europe, and Asia. His market commentaries have been featured at major industry conferences, in TV documentaries on capital markets history, and on social media outlets. Prior to joining Ballentine Partners in 2022, he was a Senior Portfolio Strategist on GMO's Asset Allocation team. Prior to that, he was an Institutional Portfolio Manager at a specialized unit within Fidelity Investments and was the Managing Director of Institutional Investment Strategy & Research at Putnam Investments. He is a graduate of Carleton College and holds his MBA from The Wharton School at the University of Pennsylvania. Pete holds the Chartered Financial Analyst (CFA) designation, is a member of the CFA Institute and CFA Society Boston, and he holds the CFA Institute Certificate in ESG Investing. He also holds the Chartered Alternative Investment Analyst (CAIA) designation and was the founding President of CAIA Boston. Pete lives in Hingham, MA with his wife, Cheryl, and enjoys travel, cooking (definitely not a "foodie" but a "foodie wannabe"), sourdough breadmaking, and conjuring up ways to embarrass his three children.