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2021 AICA Tax Free and Tax Advantaged Income For Investors event Day 1 Panel #1; "Tax-Free Municipal Bond Exposure Through CEFs-Update & Outlook on the Muni Market"

Wednesday, September 29, 2021

John Cole Scott, Founder and Executive Chairman of the Active Investment Company Alliance moderates the opening panel of day 1 of the 2021 AICA Tax Free and Tax Advantaged Income event; "Tax-Free Municipal Bond Exposure Through CEFs-Update & Outlook on the Muni Market". Read the transcript below to hear the discussion among Mr. Scott and panelists Matt Cody from Amundi, John Lawlor from MacKay Municipal Managers of MacKay Shields, Robert Amodeo from Western Asset Management, and Stephen Candido from Nuveen Asset Management.





John Cole Scott   Matt Cody   John Lawlor   Robert Amodeo   Stephen Candido

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John Cole Scott: So now if I could have the first session of speakers join me on stage. I've got my notes in front of me. Welcome, thank you for joining us on stage for this session. As I said earlier, please, the participants are welcome to ask questions and we have some rotation to go through. And so what I'd like everyone to do is first just give a little bit of introduction to you and your firm, and feel free to touch on whatever depth and breadth you want to in your closed-end fund offerings. And I’m just going to start in the order on my screen, which is Matt Cody first.

Matt Cody: Sure, thanks John. So I started off my career performing fixed-income manager selection and asset allocation for a large multi-family office. So I actually did manager due diligence and hired some of the firms that the other panelists are from. So I have a lot of respect for the firms that are joining me on the panel, so thanks for having me. So now I’m at Amundi, part of the former Pioneer Investments team that merged with Amundi, based in Boston. We manage about $5 billion in municipal assets across closed-end funds, mutual funds, and we’re launching an SMA business as well.

You’re probably going to notice a large AUM difference between us and our competitors. So we kind of focus more on being a boutique manager with a different management style, where we kind of travel the country scouring for some of the smaller deals that are out there. Hopefully have a yield premium that some of the behemoths in the industry might not move the needle for them. So that’s kind of what we like to do there at Amundi.

John Cole Scott: Good. Would you like to go next, John?

John Lawlor: Sure. So I’m currently portfolio manager and trader at MacKay Municipal Managers which is part of MacKay Shields. I started my career down on the floor of the New York Stock Exchange back in the late 90s on the other side of the closed-end fund world trading the actual equities. Joined MacKay back in 2016. For those of you that don’t know MacKay, we’re a $78 billion municipal asset manager wholly owned by New York Life. We manage those assets out of two offices, one in Princeton, New Jersey where I’m located, and one out in Los Angeles, California.

Our product lineup includes mutual funds, ETFs, limited partnerships, and closed-end funds. So regardless of the wrapper, we think the best way to capitalize on the inefficiencies of the municipal market is to focus on active management with a relative value approach and look at the municipal market through a total return lens.

John Cole Scott: And also you have some of your funds that partnership with--

John Lawlor: With RiverNorth.

John Cole Scott: RiverNorth, sorry. I’m like Patrick Galley. That’s more than Patrick.

John Lawlor: Correct, yes.

John Cole Scott: Anyway, thank you. And that’s how we got introduced, appreciate that. Robert, would you like to go next?

Robert Amodeo: Sure. It’s a pleasure to be here, look forward to a great conversation. Robert Amodeo, Western Asset Management, head of public finance. We’re a fixed income only global asset management firm with offices around the globe. I started out at Salomon Brothers Inc. on the broker-dealer side where we were managing kind of unique, kind of illiquid investments for the managing directors. Then was invited to join their asset management group and through a couple of purchases and mergers and acquisitions I've been here at Western Asset Management for the last 15 years.

We have three primary clients, institutional clients, high net worth individuals, and mutual funds, and pretty much every type of portfolio that you could imagine within those three types of clients.

John Cole Scott: Great, and last but not least, Stephen?

Stephen Candido: Afternoon, thank you. Steve Candido, I'm with Nuveen Asset Management, Chicago. I've been with the firm 25 years, I've spent almost all of that time in munis. Having started out back in the mid-90s in the UIT area, spent a lot of time in muni research covering predominantly high-yield muni investments and now currently a portfolio manager with our muni team. We manage roughly $220 billion or so in munis, that's split out across mutual funds which is just under $80 billion, closed-end funds just under $50B, and the balance of that across SMA, institutional, and other structures like limited partnerships as well. And we are owned by TIAA-CREF and we are a subsidiary of them.

John Cole Scott: Great, and thank you so much. Now that everyone in the room now has a better sense of who you are, we loved to re-hone in on the closed-end fund structure. So the question will be please describe something you think is unique about your municipal closed-end fund portfolios, and this time I'm going to start with John.

John Lawlor: That's great. So as you mentioned John, we co-manage or sub-advise for the RiverNorth closed-end funds. We currently sub-advise on four of their closed-end funds. We also have our own Mainstay branded closed-end fund that we manage here. But the RiverNorth closed-end funds offer a very unique strategy in that for those of you that don't know RiverNorth, they are a boutique asset manager based out of Chicago, Illinois who have made a name for themselves with trading the closed-end funds as discounts and premiums to NAV as opportunities present themselves.

So what makes this partnership with RiverNorth interesting for us is that they look at the closed-end fund space the same way that we look at the muni market, so through a total return lens, relative value, active management. And what these four products do is, at a very high level you roughly have half of the asset managed by RiverNorth and half the assets managed by us here at MacKay Shields. So the RiverNorth side of the portfolio they're actively trading closed-end funds, municipal closed-end funds they're trading at a discount. As those discounts widen they'll buy more, shift to the closed-end funds that have wider discounts, as those discounts narrow they'll take some of the alpha off the table and sell some of those closed-end funds.

So we on the other side manage the municipal bond portfolio. We create a lot of the leverage in the portfolio through TOB structures, and we have flexibility to allocate towards investment-grade, towards credit, or towards taxable municipals based upon where the relative value presents itself in the market. So we can shift assets back and forth between the two sleeves based on opportunity set. So as many people probably know, most of the closed-end fund investors are retail investors, more than likely don't make the best investment decisions or timing in the marketplace. Closed-end funds have a seasonality to them from a trading perspective, so as those closed-end fund discounts widen or narrow, we can take advantage of that and capitalize on some of those inefficiencies in the marketplace.

John Cole Scott: Great, thank you, John. Robert, would you like to go next?

Robert Amodeo: Yeah sure, thank you. I think just to add onto the last comment there, we believe that the municipal market is inefficient, it's opaque, it's illiquid, has generally a poor disclosure although some of those factors are improving. So here at Western Asset Management what we look to do is collect, collate, and analyze information that we think we can gain an information advantage in the market that's inefficient. So we're looking at identifying and capitalizing in securities that are just priced too cheap given their fundamental value, and their fundamental value is determined by our credit team dedicated to public finance.

I think the hallmark of Western Asset Management though is really to offer a well-diversified value approach to our clients. And so no one position in our portfolio is going to dominate our strategy, and all of our strategies have to fit within a well-defined risk budget. So I think broadly we like to offer our shareholders a portfolio that's going to stand up in different market conditions. I think the biggest difference is the amount of leverage our portfolios for a variety of reasons just tend to have a little less leverage. But beyond balance, it's a well-diversified valued approach that we deliver.

John Cole Scott: Great. Matt?

Matt Cody: Sure. So we just launched MIO. We capped that fund at $300 million, consistent with what I mentioned previously, our strategy is to look at some of the smaller and mid-sized deals. If you look at the average deal size of the muni market, somewhere around $40 million in the high yield space. So we'll look at $40 million deals, we even go down to $10 million deal sizes. So if you were managing a really, really large fund, something that's a $5 or $10 million deal might not be worth the effort to analyze, but for our portfolios we can make a meaningful sized position in those securities.

So we like to add value that way, hopefully finding yield premiums in areas that are less trafficked by other investors. And the second thing we like to focus on is yield curve placement, so there's a perpetual steepness in the municipal yield curve. And by extending your maturities by a few years or kind of tactically planning where you're buying on the muni curve, you can buy a bond, hold it for a few years, and sell it as it rolls down the curve, hopefully at a premium price. We think in an environment like today where spreads are compressed somewhat and your base yields are fairly low, you need to find a couple other avenues to generate returns and that's where we're finding some value add right now.

John Cole Scott: Great, thank you. And again, Stephen?

Stephen Candido: So how are our Nuveen funds unique? I think what really sets us apart is our product innovation, our breadth of product offering. When you look through the types of strategies that we offer in the closed-end fund space, we've got a high-yield investment grade national blend, we've got investment grade national both leveraged and unleveraged, we've got intermediate funds, we've got AMT-free of course state specific funds. And more recently we've got a strategic muni opportunity type fund, NDMO, launched last year, just roughly about a billion dollars there. Which is a little bit new in terms of the structure and that it's not purely an income driven fund, it's going to be more total return and more strategic in nature.

So I think thinking along those lines we just have a I think a product or a fund that really dissects the market and allows the investor to go in and find what they might see as an opportunity in the marketplace. And invest again in an active strategy where we're again doing what other investors here on the panel are doing, which is trying to seek out those inefficient bonds, the bonds that offer the best opportunity for upside potential.

Number two I think in terms of the way we manage our funds from a product standpoint, I think trying to maintain dividend stability, we take a lot of pride and a lot of effort to make sure that the balance between our UNI balances and our earnings potential. And balancing that to make sure that we can maintain a fairly stable dividend over time that's not going to be surprising investors month to month but really try to make sure that we can sustain a dividend as long as possible.

And then finally I think more so in some of our high-yield funds and strategies, we've been taking on more in the distressed space and defaulted securities space for products that might be a fit for. And I think one area where I think we excel in terms of being able to be involved in some of the more distressed workout scenarios where a particular fund may not specifically own a large amount, but on an aggregate basis within the firm or a dominant majority owner driving the workout where that one individual fund that has a smaller amount will benefit from our workout in that investment.

John Cole Scott: Good. And also I would be remiss if I didn't mention that you guys have seeded an interval muni fund at your firm and will be hopefully in the market later this year for investors to my knowledge.

Stephen Candido: Correct, yep. Yeah.

John Cole Scott: All right, well good. So going to the next question, given the current level of interest rates, how are you positioning your closed-end fund portfolio? And first we will go back to Steve.

Stephen Candido: Well, you know as I mentioned we have funds that have different mandates of course, so how we manage one fund's going to be very different than the other dependent upon the strategy and what the ultimate mandate is and the goals. But I'd say that one thing that's been I think consistent for a lot of our funds in the past year or so is that we've obviously seen an environment with yields dramatically low, and the nice thing about closed-end funds is that you don't have that influx of cash that dilutes down your earnings potential.

So we've got very, very strong legacy positions in many of our closed-end funds that have very attractive coupons, we call them cushion bonds with a coupon that's significantly higher than where current levels are. So those bonds trade at a significant premium, which provides some cushion in the event of a backup of rates. But as those bonds that we've owned for many periods and have acquired during periods of weakness, those bonds still kick off a lot of income. But they've rolled down the curve and have given us more duration capacity in these funds so that if we see a backup in rates like we're starting to see right now. It presents the opportunity for us to potentially extend duration and take advantage of great income opportunities out there in the marketplace.

And I'd also just say that I think patience again during some of the peak periods and low yield environment. Maybe not jumping at some of the frothier type of structures and frothier type of bonds that are out there in the marketplace, but being patient knowing that we have very strong earnings in the fund and waiting out the opportunities and moments of weakness in the marketplace to take advantage.

John Cole Scott: Good, and we're going to go Robert next. But remind the panelists, we've kind of done two speakers per question, but if another speaker has a strong opinion or a counterpoint, definitely want to give you the opportunity for a short counterpoint. But Robert, please answer the same question if you will.

Robert Amodeo: Yeah sure, thank you. The idea of duration obviously it brings up the point of sensitivity to rate changes, but also here at Western we also believe that duration can help to act as a ballast to any of the spread sector volatility that we may see say from a potential economic setback or any other fundamental challenge. But we use duration not just for interest rate sensitivity but at times as a diversifier for some of our spread positions. I think earlier this year it's obvious that our portfolios had a little bit longer duration since the elevated inflation concerns that were getting priced into the marketplace, we thought it was just a little bit overdone. Being respectful and understanding that the recent elevated inflation is real but we were in the temporary camp, transitory camp if you want to put it in terms of the press.

But I think looking ahead, I guess since the earlier part of this year we have allowed our durations to drift a little bit for a variety of reasons. But I think looking ahead, the case for immediate rate hikes coming out of the Fed may not be as strong as some may believe, and some being priced into the marketplace over the last couple of days. I think we have to mindful that the Fed has explicitly stated that there's a couple things that have to be matched before they begin to hike their rates, inflation above 2% on a sustained basis, and then of course maximizing employment. So I guess all those things considered we're a little bit longer duration heading into the middle part of this year, into this third quarter we've allowed it to drift a little bit. We would look to any sizeable increase in rates here to take advantage of that by extending duration a little bit.

John Cole Scott: Very good. Any counterpoints from John or Cody? I'm sorry, Matt? No, all right, we'll go to the next question. Next question is most municipal closed-end funds use leverage as we've discussed, please let us know how your fund has set up different types of leverage and what is a normal leverage amount or range for your fund? And the first person will be John Lawlor.

John Lawlor: Great, thanks. So we utilize two forms of leverage in our closed-end funds, one is TOB financing, and the other is a credit facility that we have set up. So the credit facility is a little bit more nimble, we can draw upon it on a daily basis and TOB financing is more so what we do on our side of the municipal bond side of the portfolio. So currently we're anywhere from 30-35% leverage across our funds. That's a little bit below where we typically run the leverage. And that's really just based on opportunity set in the market. So on average I'd say we're somewhere plus or minus 40% for leverage across the funds. And if we get a little bit of volatility, if we get a little bit of backup in rates we'll certainly reapply some of that leverage, reset some of the book yields a little bit higher at a more attractive entry point in the portfolio.

John Cole Scott: And the breakup of the different types of leverage you mentioned by how the leverage will be affected by the rates, is that part of the mix that you're deploying in line with your opinions on the muni markets direction of rates?

John Lawlor: Absolutely. As spreads tightened over the summer and rates just grinded a little bit tighter, we took the opportunity to take some of the TOB financing off, reduce some of the leverage there, use a little bit more of the credit facility. It made sense from a cost perspective to do that. And then as rates back up here, we're certainly keeping an eye on opportunities in the marketplace and whether or not to shift some of that leverage back to TOB financing.

John Cole Scott: Great, thank you. So Matt, can you give us some perspective of how you guys work with leverage, deploy leverage, swap leverage, tolerance spans for leverage and the like?

Matt Cody: Sure. Well, on the lines of what John was mentioning, not only the amount of leverage is a tool for active management, but the actual type of leverage is also a lever that managers can pull. And actually throughout the life of a closed-end fund you can actually shift what types of leverage you're using. So one of the ways that you can lever that hasn't been mentioned yet is more the equity route, if you're issuing preferred shares.

John Cole Scott: True.

Matt Cody: So as John mentioned for the debt financing, that's more flexible. You can take it up, take it down as you see fit, but there tends to be a cap of how much you can actually borrow from the debt based on the assets in your portfolio. With equity financing you can actually take that leverage up a bit higher but it tends to be less flexible on a short term basis, you can't really toggle it up and down as much. The TOBs you can add on top of either of those two main choices for leverage, so you can still have some flexibility.

So really between those three ways of accessing your leverage based on what the current market environment has, based on rates, based on what you're going to get the most value for for your clients, you can move between those three. So we use all those methodologies for our closed-end funds. Two of our closed-end funds have preferred shares offered to add equity leverage, and then MIO right now we are planning on using debt financings as we ramp up. And we're between 30 and 40% based on what we see in the market.

John Cole Scott: And it makes a lot of sense. As I mentioned in my intro session, the actual ability to offer preferreds equity as leverage is part of the closed-end fund structural advantage. That piece is not possible through ETFs and open-end funds. Would Robert or Steve have any counterpoint to the use of leverage in a different perspective? No? That's fine. All right, so the next question is should we be worried about pension state deficits for any or most states? And we thought we'd get this from Matt.

Matt Cody: Sure, I'll take that one. Well, so overall we would say state finances have been improving. We like the fundamentals, this is a really strong point in the market for us. If you look at the three main revenue sources for municipality, for state, being income tax, sales tax, and property taxes, actually pre-Covid to post-Covid all three of those facets are up on average. Doesn't mean that they're up for each state, but if you pull them all together it's actually higher. So revenues were up and then on top of that you had a bunch of federal support in the last Covid relief package [inaudible] billion was earmarked to help local and state municipalities. So we think they're in pretty good shape.

So along with that, pension funding has gotten a bit better as well, but I think the main reason for that has actually been the strong investment performance. If you look at some of the largest pension funds out there, I think New York's $270 billion pension fund gained 33% year-over-year from the investment performance. I think some of that has to do with the timing, I think their fiscal year ended right after the Covid hit. So I think they started in April 1st is when their fiscal year started, but there's similar numbers across the board. I think [inaudible] which I think started in June, so June to June that's more of a fair comparison, they're up 20%. So just the fact that the markets have been so strong for what they've been investing in, that really helps push those numbers down.

So I think overall it's looking better and a lot of states have started decreasing their forward-looking assumed rates of return. Which is good, it takes some of the aggression out of the accounting numbers. But then there are definitely pockets of weakness, Illinois is less than 50% funded, we wouldn't be surprised to see them get downgraded to junk at some point. New Jersey is also under 50% funded on their pension, and Connecticut as well. So there's some pockets out there that we would avoid, but in general, at Amundi we don't tend to have a large allocation to state geos in our portfolio so we're not overly focused on it.

John Cole Scott: Thank you, Stephen, could you add some perspective as well?

Stephen Candido: Yeah, so should we be worried about pensions? I think generally for most states, no, they're in decent shape. For some, yes. And it seems to me that as of late pensions really have kind of fallen by the wayside somewhat. I think there is so much concern about getting through Covid from state and local government perspective, and just trying to get through the hump here that they either put off in 2020 the focus on a lease in terms of pension funding. But I guess it became less of a forefront issue and I think it'll come back for certain states like New Jersey, Pennsylvania, Kentucky, Illinois.

But I think the big story here really is that in 2020 we had a significant drop in funding across the board, across both states, dropped to below 70% in terms of funding ratios. And the story for 2021 is going to be this huge pop we've seen in terms of investment returns. We've seen a 25% average market return in 2021, the funding ratios are the best they've ever been across the states since 2008. However again, states with the lowest ratios like I said, Illinois, Pennsylvania, despite increasing their contributions significantly to about 16% over the past five years, they're still very well underfunded.

So Illinois by example, just below 40% in terms of funding, however they've had a very, very strong year. So in the short term Illinois looks much better than they did potentially last year and what people were worried about happening to Illinois. In fact we saw the ratings improve just this past year. I think Moody's was an upgrade, they had 10% year over year sales tax growth, income tax growth 25% year-over-year, of course that's from a very low number, 2020. But again the issue for Illinois long term is going to be the pension funding. And despite the fact that they're increasing their contributions, their contributions and what they're required to contribute each year still continues to grow the ultimate gap of what they're actually supposed to be contributing to the pension.

So it's only going to be a larger and larger problem that will continue to snowball for Illinois I think unless it's addressed longer term. But short term I think Illinois looks fairly strong quite frankly in terms of the revenues we're seeing and some of the bounce back we've seen. So as a buyer of Illinois, I'm comfortable buying Illinois bonds at the right levels. I don't think +40, +50s the right level, but longer term clearly pensions are going to be an issue that's going to have to be addressed. And I think it is cause for concern for some of those states longer term.

John Cole Scott: And you say +40, +50, you mean basis points over the par yield?

Stephen Candido: Yeah, I mean Illinois where they might trade versus a AAA muni bond. So if a AAA muni bond is 1%, I'm not paying 140, 150 for Illinois even though they do look better than they have been. Now back last year when we were trading +200, +300, it was a different trade.

John Cole Scott: Great, thank you very much. And next that would be Robert.

Robert Amodeo: I think pensions are always kind of a hot topic depending on market conditions. I agree with one of the commentators where it's gone sort of from the front burner back to the middle burner, if not the back burner here. But at Western we're going to look through a broader lens, because if the pension plan is missing funding or the assets are shy of the upcoming liabilities, you're going to have to look to the balance sheet of the sponsor, the state or the local government or whomever, wherever the cash is going to come from in a pay-go as we would say. A pay-go is just going to pay the pensions directly if there's no assets in the pensions. So if you look through that broader lens, you could not have a better landscape in the public finance marketplace.

Think about all of the credit concerns we were talking about just last year. I'll use Illinois as an example, people were discussing the idea of them defaulting or falling below investment grade into the high-yield arena. That's not even part of the conversation, they're no longer on credit watch negative. And you can go region by region, there's certainly disparities and regional disparities in economic recovery, but tax receipts have come back extremely strong and in some regions they're actually above pre-pandemic levels.

I think the biggest issue is we have essentially upstreamed major concerns from the state and local government to the federal government by virtue of the federal government down streaming massive amounts of capital to the state and local governments. So I think at this point given the financial strength or at least the financial gains that we've witnessed over the last year, year and a half in these pension plans, and they've grown more aggressive in their risk profile and it's worked out well for them. The tax receipts are coming in very strong, reasonable budgets, improved financial flexibility, and we've upstreamed major concerns to the federal government. I think it's less of an important issue today than it was say half a dozen years ago.

John Cole Scott: Got it, thank you very much. I realized I called on the wrong person, hopefully you guys can pivot a little bit. So the next question is what sectors or states are you the most optimistic or pessimistic? And for that one I will go for Matt first if that can work for you?

Matt Cody: Well, my answer on that one will be pretty brief. We tend not to invest by overweighting or underweighting states. We look for individual securities, we try to focus on alpha and not on beta. So as mentioned, we don't have a lot of high level GO exposure. We're looking for small charter schools in Texas sort of a thing as opposed to broad state finances. I'll let the other panelists who are probably better experts on answering that topic handle that one.

John Cole Scott: But it's a useful distinction for how your funds are different because of how you think about the different credits in the market.

Matt Cody: Yeah, definitely. Yeah, I think both are very valid investment strategies and both have worked really well over time, and they tend to be compliments to each other. So yeah, we look at state financings because it has a trickledown effect, so it's important, we notice that.

John Cole Scott: Thank you. John?

John Lawlor: Yeah, absolutely. So with munis and the inefficiencies in the marketplace, credit research is ultra-important in this asset class. But what is also critical within that credit research is not only looking at the balance sheet and the cashflows, but also looking to state and local policy. Looking at who's making the tough choices, who's doing what's right for the tax payers. And to use my colleague's example, state of Illinois, when Governor Pritzker came in, we became very bullish on the state of Illinois. It was trading, as Stephen said, +250, +300. We like that trade, Governor Pritzker made some tough decisions. It was the only state to tap the Fed municipal lending facility, which could have been deemed as a credit negative or negatively by investors. But he knew that he couldn't access the open markets at a lower rate where the Fed was willing to lend the state of Illinois money. So as my colleague said, the recent upgrade by Moody's for the state of Illinois is certainly something where politics came more into play than the underlying credit worthiness of the state. So that's an important perspective from our point of view.

From a sector perspective, coming into the year we looked at a lot of the Covid-related sectors, so healthcare, transportation, travel related sectors in the marketplace. We had an idea that those were going to continue to recover as the economy reopened. Give you another example, healthcare, hospitals, I can almost guarantee you that no one in DC had the stomach to let a hospital go belly up in the middle of a pandemic. So we increased our allocation to hospitals at a time when they were trading wider than the rest of the marketplace. It presented a relative value opportunity from a sector perspective and then we also dove into each of the individual credits as well.

John Cole Scott: Very good, very good. And again, Robert, intending that was a question initially for you. If you have anything to add, I apologize for giving you the wrong question earlier if you want to add anything.

Robert Amodeo: No, that's fine. Ask any question you'd like. Our bias is always to revenue bonds over GO debt, just a couple reasons. One, you tend to pick up more income when you own a revenue bond. Two, the balance sheet is less complicated, it's less susceptible to a political decision. And then three, it tends to outperform GO debt. Except where you have these high beta names like in Illinois, Chicago, Chicago Board of Ed, Jersey, just to name a few. But we tend to bias revenue bonds and heavily overweight revenue bonds. With that we tend to focus on the lower investment grade part of that credit spectrum, single A, BBB, below investment grade.

I think it's obvious the hard hit sectors in the pandemic offered the best value, so with that we've been focused on transportation, higher education, some healthcare issuers, not all. And then some selectively in those travel, entertainment, hospitality sectors as best as you can get to them without getting out over your skis in terms of digging too deep into issuers that may be troubled for a lot longer than some suspect. But right now within our macro outlook is really centered around the reopening optimism with a healthy dose of humility about just the incredible number of potential outcomes in a post-pandemic world.

But we're still looking for those issuers, not necessarily sectors but issuers within the sectors that we talked about just briefly that have not enjoyed a full return to pre-pandemic conditions and that still are trading somewhat wide to where we think they potentially could be. But broadly we're relatively upbeat on muni credit, but we are cautious especially in this marketplace, not over the last couple of days but where bonds, the prices have been stretched well beyond their fundamentals even with optimism embedded in our macro case.

John Cole Scott: Very helpful. Well, good, so the next question is what is your outlook for muni bond issuance? Because as you know we've been talking a lot about your work with trading bonds or bonds that are already in the market, but you must have a thesis for that outlook as you didn't make relatively value swaps or get access to new bonds. Matt, would you like to start that question out?

Matt Cody: Sure. We talked both about some supply and demand, obviously the demand has been there, there's been non-stop flows into the space. The overall supply has been there somewhat to match in terms of dollar amount, but when you look down under the hood, the problem with the tax-exempt investors is that a larger and larger percentage of the new issuances coming as taxable bonds. So expecting about $12 billion of supply this week but about $6 billion of that is taxable, so that actually kind of constrains the amount of supply for people that are looking for tax-exempt bonds. Taxable muni bonds are about the fastest growing segment of all fixed income spaces and we expect that to continue, especially when you have overseas investors where rates are still primarily negative across Europe and in places like Japan.

When they're looking at negative yields and they come over here and they see our AAA and AA muni bonds, your Harvards for example yielding more than Greece, probably about the same after adjusting for currency, you can see why they're interested. So there seems to be more demand coming from overseas, so we're not surprised that issuers are kind of playing into that and offering a higher percentage of their issuance in taxable form. So we think that's going to be constraining long term on supply, so I think it bodes well for who already owns municipal bonds because you're going to have a little bit of a continued tailwind from demand and not so much supply to kind of make up for it.

John Cole Scott: Robert, would you like to add your perspective?

Robert Amodeo: I think just in general we're expecting an increase in supply over time. You'd have to say coming out of the pandemic, not a lot of spending, not a lot of spending programs being put into place just because of the uncertainty. So as the economy continues to reopen and things continue to normalize, you'd have to expect supply to pick up over time. I think though the answer really largely depends on what tax proposals end up in the final budget negotiations and packages. With that if advanced refunding returns, Build America bond programs return, this could really impact the supply in the muni market infrastructure. Certainly going to impact the supply in the overall market, but it depends on which provision finds its way into the tax proposals and the budgets that are being passed as to whether you see an increase in taxable supply, tax-exempt supply.

I think more importantly we're looking at what the shift looks like and how quickly supply moves from taxable to tax exempt and vice versa, and that I think is probably the largest potential impact on bond prices, is the shifting mix between taxable and tax-exempt supply. But overall we're expecting a modest increase in supply over time, the market should be able to handle it quite well, but the shifting mix is something we're a little concerned about.

John Cole Scott: Very good, and so next question we'll start off with Stephen. And as we sort of touched on in the last topic, we've been hearing about potential tax changes in Washington that could theoretically impact these investments. Do you have any opinions, perspective, what you've heard from your folks? And then also you're welcome to touch on the issuance supply as well.

Stephen Candido: Sure. Yeah, Joe Biden, the president was supposed to be in Chicago today but he cancelled the trip for this purpose. It's such an important piece of legislation that he's trying to get across the finish line, and it just goes to show I think this battle that's been going on within the democratic party among progressives and moderates. And now they're looking to push through an infrastructure package that's decoupled from the overall spending bill. And then you have progressives saying, "No, not so fast. We want to use that as leverage so that we can get this larger spending bill put forth."

But I think for munis and for our investment and asset class, I think Robert touched upon some of the highlights there that are within some of the bills, and these were late adds mind you, the Build America bonds and the advance refundings coming back. I'd add the SALT cap as well to that list. I think what's going to be interesting that comes out is, what's going to be the give and take? It sounds like the SALT cap of $10,000, it sounds like there are enough legislators in certain states like New York and California, high tax paying districts that are adamant to hold on to try to get some type of revision. And I think they'll have to capitulate to some degree, we may see some softening I guess of the SALT cap, maybe gradual over time.

But it's a very, very costly measure, and in order to accommodate that, does that mean that they have to push aside BABs, push aside advanced refundings? I'm not sure. But I think this is going to be a telltale week, we'll see where it goes, it's such an important piece of legislation. On the advanced refunding side, I think state and local government, I think this is really their priority if you asked me just because of the amount of savings that are potential if they're able to bring those back. You just look at Chicago Board of Ed as well for instance, some of these issuers that have these very sizable coupons with shorter calls, they'd probably love to be able to advance refund those tax-exempt marketplace. So I'd expect to see a sizeable increase in issuance if that comes back to the forefront, see advanced refunding for munis again.

John Cole Scott: Great, thank you. John, could you add some perspective as well?

John Lawlor: Yeah, absolutely, I agree with Stephen's points. It's a delicate dance that's going on down in DC, and as painful as it is to sit there and watch the negotiating process, it's a process that has to play out. To echo some of his points, the subsidy bonds are BABs 2.0. Right now it's on the fringe, it's one of the items that's being tossed back and forth on whether or not it's going to be included as is advanced refunding. So regardless of what that package looks like when it's all said in done in a couple weeks in October, October 18th is right now the estimated deadline for hitting the debt ceiling, regardless of what that looks like, taxes are going to go higher for high earners and for corporations.

We've already seen a little bit of that preemptive flow into the municipal marketplace. We expect that to continue, but taxes are going higher. I do think they'll get something done, there'll be some type of compromise between moderates and the far left. The SALT cap I do think goes through in one form or the other. Right now it's in the form of a temporary two-year relief, but when push comes to shove, Senator Schumer in New York who's been a big advocate for it, obviously a pretty powerful man down in DC had promised to bring that back in one form or the other. So one of his priorities is going to make sure that that comes back in one form or another.

Stephen Candido: Yeah, and John makes an important point again that I'd just reiterate as well. That no matter what happens I think the consensus is that taxes are going higher and it's a positive for munis. Corporate taxes going up to 26.5%, individual up to 39% plus, capital gains, I think just giving lip support to the muni market. And I think that's an important point John was making.

John Cole Scott: All right, hopefully Robert comes back. There you go.

Matt: If you don't like an answer, John…

John Cole Scott: You can just close your camera off, you walk away, maybe just wanted to change his box on my screen to confuse me, I'm not sure. Welcome back, Robert. And so as you look to wrap up these prepared remarks and open up for the question and answers from the audience, I'd let the audience know if you have a great question, please enter it into the queue. I see one already. But I'd like to give each one of you a chance to say, and as you planned this discussion and we had the preparation call last week, is there anything you really had hoped to discuss in this conversation that you wanted to make sure the audience was able to hear? And I will start with Robert for making me move.

Robert Amodeo: I think it's been a great conversation, I'm so glad to be part of it. Yeah, I think if there is a topic that is important just a year or so ago it seems to have died down a little bit. But as you look to muni bonds and if you're looking for an impact type investment strategy, municipal bonds offer a unique opportunity for investors to align their investment goals with their impact objectives, ES&G. I think people overlook the fact that the majority of the municipal bond market issuers and issuance is green and is there for the social good. And economic environment good, clean water bonds, water and sewer bonds, and so forth. So I think as we talk about our various strategies, curve sectors, issue selection where we march up and down leverage and issue selection, be mindful there's also impact investing that's behind this.

John Cole Scott: Very good point, that came out in one of our panels in the spring. I wasn't planning on it but between BlackRock and Invesco about ESG in the credit market, so thank you for bringing us back to that point, Robert. Stephen, would you like to add your perspective or thought that you wanted to make sure was covered today?

Stephen Candido: Well, just going back I guess thinking about just the fundamentals of the fund environment, whether that's open funds for closed-end funds. I think when you look at opportunities in that space and you look at the distributions and the dividends still despite being under pressure, at least more so on the open-end fund space given inflows and whatnot into the asset class. When you look at the fund distributions of many mutual funds and many closed-end funds, they still look very, very attractive relative to where you can actually go and buy underlying bonds today.

So I just think it's a very compelling investment opportunity, especially as you look at the last week where we've seen this adjustment if you will in treasuries and also now into the muni marketplace. I think it's somewhat short-lived. You've got the debt negotiations going on, you've got an unprecedented infrastructure and spending bill package being looked at. You've got the Fed talking about 4% inflation and hopefully coming down to 2%, I think it is somewhat transitory even though it takes a little bit longer. But I think the underlying health of the muni market is very strong. The asset class has been very, very resilient through challenging times, whether that's in '08, whether that's in the Taper Tantrum of 2013 or post-election 2016. So I'd kind of leave with that thought, that at least I think the underlying asset class if very strong and the earnings right now that are being paid out in the fund category relative to the underlying bonds still look very attractive.

John Cole Scott: It is, and as I said in my introduction conversation how discounts are narrower or premiums are expanded from when we first started tracking that in our index business. But at the same time everything's gone. It's not like everything else has stayed low and munis have stayed higher or preferreds, the entire market's gone in that direction. And I was really surprised and pleased in dollars terms that our index of the diversified funds was showing more dollars to investors over time. Which again is a goal of them being a pure buy forever bond investor where the coupon doesn't change. And so I think that's to me why not just I was born earning closed-end funds, why I love the wrapper for investor interaction.

All right, sorry for that editorial note. John, would you like to share anything that you thought that you wanted to make sure to cover today?

John Lawlor: Yeah, absolutely. I think it kind of ties together a couple of my fellow panelists comments. Robert's comment about ESG, it's certainly coming faster than I think anybody else expected, and the municipal marketplace is very green in nature with projects that we finance. And then Matt touched on the fact that the international buyer is evermore present in the municipal marketplace. And as you have this increase in taxable municipal issuance and given the green nature of the municipal marketplace, that's only going to continue to grow. So I think the average investor should start paying more attention to the taxable municipal side of things. You can really have an allocation whether it's in a retirement account or even in a taxable account where you can generate. You have better credit quality, you have better diversification versus the corporate marketplace, and you have some trading opportunities there where you can generate some alpha as well.

John Cole Scott: Well, that means for the firms that don't currently have taxable muni closed-end funds we should get on the IPO calendar to create some to give for people like me more options for our clients, individuals themselves. I think that's just future product development for everyone on this stage. So Matt, would you like to give any perspective that you'd hoped to share? Again, make sure your thoughts are fully fleshed out for our guests?

Matt Cody: Sure. Well, yeah for the guests I'm guessing that they're getting the same question that I'm getting a lot.

John Cole Scott: Well, I meant audience, but yes.

Matt Cody: The audience out there, the other advisors. Because we're getting asked, "Are munis still an attractive asset class?" and I think it's kind of a summary of everything that we talked about. But Amundi we look at three things to answer that question, we look at fundamentals, we look at technicals, and we look at valuations. Through our discussion today we definitely touched on fundamentals and how most states and local municipalities are as strong as they've ever been from a fundamental, from a balance sheet standpoint, and from a revenue standpoint. So we think that's in a really good place.

The technicals, we talked about tax increases likely coming. I don't think you can come up with a stronger technical environment than that like, "Hey, your tax rates are going up so therefore your tax adjusted yields are becoming that much more important." We also talked about the supply and demand imbalance, that that's also a strong technical tailwind to the space. And then the final piece is valuations, and John, I saw on your presentation before this panel started, you were showing tax-adjusted yields. And I think that's important to look at because what else can an investor purchase? I think your chart, you had your tax-adjusted yields somewhere like 6.5 or 7% or something like that.

John Cole Scott: For very high earners both federal and in New York City just to give that God-loving biggest tax rate.

Matt Cody: Yeah, yeah, so kind of depending on what level you're using to tax adjust. But I think the point is it's hard to find some of those yields out there in the taxable market. So even though muni spreads have compressed, yields have really compressed everywhere, and I think on a relative basis it's still a strong asset class that we have a positive outlook for.

John Cole Scott: Good. So again let's get to the submitted question here, and anyone who wants to chime in can. How should investors think about the relationship between SIFMA and treasury interest rate curves? They're related but we definitely saw some dislocations, even pre-Covid but definitely during Covid. Does anyone have opinion or perspective on that? All right, you'd feel like I was asking about activism.

Robert Amodeo: I can take it if you'd like. SIFMA is a short-term borrowing rate and people would always think LIBOR, whatever's going to replace LIBOR, SIFMA is a municipal rate that's set in the cash market. And largely it's dependent upon where other rates, are and then the tax-adjusted rate and the SIFMA rate certainly is using taxable rate as a reference level. But more importantly it's supply versus demand equation, we call them variable rate demand notes. How many variable rate demand notes are in the marketplace along with the tender option bond certificates that are used for leverage versus the amount of demand for cash.

And right now the rate is around almost zero, it's been ranging between 2 and 7 basis points for a very long time now. So there is some linkage to a taxable reference rate. But more importantly in today's marketplace where rates are zero pretty much in the front part of the curve and pegged at zero, it's more about supply and demand of the types of securities that are in that marketplace.

John Cole Scott: Thank you very much, Robert. I was just sitting here and thinking it just reminded me we didn't really talk about calls. And I remember we took over an account from an advisor where they had a 6% small town in Virginia bond, and I remember calling up the guy that issued it because I happened to know him and he goes, "Oh yeah, that thing hasn't traded in about a year, and so I don't think you have to worry about that bond getting called. It's too small of a play." So we didn't talk anything about calls, but the call exposure, you think about the call risk. Anyone want to chime in that has a strong opinion about how investors should look at the call data you guys provide in your fact cards and through our data business in their approach to looking at the muni market?

Matt Cody: I can start off with that one because that's a positive note for team small issuer over here. We would say that there's a correlation between the size of the issuance and how often bonds get called as John, just for exactly what you mentioned. There's a fixed-rate cost or a fixed cost to calling and refunding, and kind of the smaller the issuer is, the bigger deal that is and I would say the less likely that that is to be called. So there is kind of a potential alpha engine out there if you can search out bonds that are trading at a high coupon. If they're a premium bond and you think that there's a chance that they don't get called, that's another way that you can add some active return on top of just whatever your stated yield is in this market.

And then just a side note just on that question that came in, there's a chance that this also might have been aimed at, "Hey, what do you think the relationship is between the muni curve and the treasury curve?" Basically being a question of, "I'm worried about rates going up. What's going to be happening to the muni curve?" If you look year to date, 10-year treasury is up about a little over 60 basis points, where a 10-year muni like a AA is up just over 40 basis points, and that's a pretty steady relationship that munis tend to move less than treasuries.

So if you're worried about rates going up on the taxable side, usually your munis have at least historically provided some sort of a buffer, a little bit less sensitivity to the rising rates. And then we also talked about the yield curve steepness, if you've got 50 basis points of steepness over 5 years, that means rates can go up 50 basis points over that 5-year period before you start eating into a price there over that time period. I think if rates go up I'm not saying it's going to be great for munis, but I think that our asset class can fare better than a lot of the other asset classes out there to choose from.

John Cole Scott: And again, our strategists always tell us it's more of the pace of the movement. Like if it's faster than they expected, it's the most painful on the upside and most beneficial on the downside. The market can digest these things if it happens to be more measured over time, which is usual, at least historically speaking.

I was just thinking in my head, back through Covid the muni bond funds were showing betas like the S&P 500 and the conversations we have with clients and advisors about what risk really is, and how volatility is such an MPT definition of risk. And I think a lot of people will say, "What's your Sharpe ratio? And what's your efficient frontier?" And to me with the closed-end fund wrapper, the fact that you're in that fixed capital structure, you definitely don't want to be a margined forced seller during a Covid-like pullback. But if you just didn't do anything, nothing bad happened.

Can you imagine if you guys had ETF wrappers over all of your muni funds in March of 2020? Or open-end fund wrappers? And the redemptions really could impact even your leverage ratios and other factors. So I find my PSA, whether we're talking about munis or any other sectors, reminding people that the volatility is your liquidity. And really the NAV and that fixed-capital structure, the reason why there's humans doing this work is it adds some value and to try to avoid you making decisions through the worst time possible. And so that thought was in my brain, I definitely wanted to hopefully share and vet it.

And the last thing, it didn't come up on this panel, but if you think about it, what's that benefit of the closed-end fund wrapper? It's you're buying a historical bond portfolio you didn't build. Especially for some of you with older portfolios, it takes a while for those older bonds to roll off your books and give some benefit to current investors, and they're putting fresh cash in the market. And so I just again another idea and perspective that we found very useful in sharing the closed-end fund piece. Because as you're all probably being thoughtful on, muni bond investors don't like volatility, but they like income after taxes. And if they truly just think of volatility they can do an open-ended product like many of you, or even an interval fund product and whatnot. I think that's the key thing. You trade liquidity, and volatility in my opinion is not the risk that we're going down to.

And with that, maybe John or Stephen can add a perspective on looking at non-rated bonds? Because I know in our dataset is X non-rated, and sometimes you say that's all bad bonds. We know that's not true but we don't know what it is. So maybe either of you, and we can start with Stephen, just how you guys look at the unrated market and think of it in the muni perspective?

Stephen Candido: Yeah, to think non-rated necessarily means it's junk or a very high risk is not always the case. I think a great example is there are bonds and issuers sometimes that come to marketplace that quite frankly don't want the rating. You look at California Community Facility Districts for instance, many of these deals will come non-rated despite the fact that they are just very, very strong underlying credits. They have a very strong retail outlet in California, they don't need to go get a rating for a $10 million deal. And the market is very understanding to that, so they'll be willing to bid those bonds at appropriate levels and the market is not spooked off by the non-rated nature of it.

Now putting aside those types of scenarios, there's a wide, wide dispersion of the types of credits that might fall under the non-rated category. We rate all of our non-rated bonds internally in house, so everything that we buy is non-rated has a Nuveen rating if you will, so we can measure the risk of those non-rated holdings. And to some extent we prefer non-rated bonds sometimes than rated bonds. We may prefer the fact that if it's a BB rated charter school, maybe it comes to market at I don't know, +180 to a AAA bond. Maybe as a non-rated bond without the Moody's or without the S&P rating on there, maybe there's more variation on where the price might be, and more discovery there, and more opportunity. So I think you've got to take it with a grain of salt that non-rated means a lot of different things depending upon the bond you're looking at.

John Cole Scott: Another question in my head I've never actually asked anyone. Does the non-rated component impact the leverage? When you talk to lenders for your funds, is the amount of non-rated conversation piece like the high yield would be for cost of leverage?

Stephen Candido: Non-rated comes into play when you're thinking about what you can put into a TOB or something like that for instance. But ultimately when you look at the regulatory leverage upon a fund, it's really based upon the underlying assets under management and how much leverage you're allowed to employ versus the assets under management. So a high-yield fund for instance isn't going to be restricted because the portfolio itself specifically has non-rated bonds. It's more about the underlying value of the assets and the amount of leverage relative to the valuation.

John Cole Scott: Thank you. John, would you like to comment on that and close out the panel?

John Lawlor: Absolutely. Stephen made some great points. From a non-rated perspective you really have to look through to the underlying security and why it doesn't have a rating. As Matt can probably attest to, some of these smaller issuers, it's cost-prohibitive for them to pay for the rating from these rating agencies when it's only going to save them 10 or 15 basis points across the curve from an issuance standpoint. So if people are comfortable with the underlying security, we have no problem buying non-rated.

Similar to what Stephen does at Nuveen, we rate every bond that we buy internal here whether it has an S&P, Fitch, or Moody's rating, or it comes non-rated. We like to, as I mentioned before, credit is the utmost importance in the municipal marketplace, so understanding what that credit is that you're buying and understanding what your security is on those bonds is sometimes more important than the stated rating that it has.

John Cole Scott: It is, and thank you so much, I appreciate everyone's time. This was such a great panel. I always love every panel like all my children, but everyone gave a lot too it. Thank you for being prepared and being involved in what we're doing. When I think back to what AICA's mission is, it's to produce high-quality diverse content for advisors that serve investors in their income needs is a major factor to the US market. And again, secondly as we've done today, we're making closed-end funds sexy again. They're not really sexy, but thank you for all of your time.

For everyone in the room, we're going to be basically coming back online at 3:20 with the next session. There's a break now to mingle at the tables, or take a phone call or grab a cup of coffee. But thank you for everyone on stage and thank you for being here.

Recorded on September 29, 2021.

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