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HIGHLIGHTS

- Liquidity is a key future challenge in the Muni bond marketplace
- Wall Street commits 50% less than its pre-financial crisis capital to risk management in fixed income
- Be pro-active with your Municipal bond portfolios

Focus on Muni Liquidity

When you invest in something, it's easy to take for granted the ease of buying and selling, as well as a reasonable spread between the underlying bid and ask prices. Because of the rapidly evolving landscape, we view liquidity as a key future challenge in the vast, over-the-counter, $3.7 trillion Municipal bond marketplace.

Market liquidity was last tested during the Financial Crisis of 2008, when the "Perfect Storm" scenario unfolded: the basic value of bond insurance evaporated and the deleveraging of large institutional investors such as "TOBs," Hedge Funds and Arbitrage accounts created massive selling pressure. Then there was far more capital committed to risk management by primary and regional broker dealers and banks. That is not the case today as the Dodd-Frank Act has imposed significant restrictions on risk-taking.

In May, at an iShares conference in New York, we learned that the capital Wall Street commits to managing risk in fixed-income has declined 50% from where it stood before the financial crisis. To compound that concern, the Municipal high yield market no longer has support from the likes of Smith Barney, Lehman Brothers and Bear Stearns, once key players in that space.

"Municipal market securities are highly idiosyncratic in terms of the individual issuer's credit quality, the essentiality of the underlying projects and a given bond's maturity and coupon structure," says Caprin trader Chip Hughey. "These factors all apply critical influences to how a particular security's liquidity is perceived. Liquidity from issuer to issuer, project to project and structure to structure can vary enormously."

At a November roundtable of chief investment officers, Fidelity Investments' fixed income CIO Christine Thompson worried about the ripple effects that just a couple of negative Muni headlines could have on the broader market for the bonds, noting that the asset manager is scrutinizing its funds' liquidity to stave off the need to liquidate holdings in a broad rush for the exits.

Be ***pro-active*** with your Municipal bond portfolios. Why force yourself to be ***reactive*** to market-driven events with a static or unmanaged portfolio? We offer sound solutions focused on mitigating risk, managing volatility and maintaining liquidity.

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