BH | *Beech Hill Advisors*

April 1, 2018

First Quarter Comment

The gurus of the municipal bond market expected a strong start for 2018 due to the record setting sales of new issues in December. However, the intermediate muni market posted its greatest first quarter loss in more than 20 years. The 1.10% loss mirrored the 1.20% for Treasuries triggered by concerns that the Fed will raise interest rates faster than at the expected pace. A global economic recovery with increased concerns over rising deficits and a tightening labor market added fuel to the fire.

In the municipal market there were positive technical factors entering the new year. New issue supply anticipated to be dramatically lower came in at 30% lower for the quarter. Even with a massive inflow of monies into mutual funds, municipal bonds yields rose along with Treasuries. The new tax law with lower corporate tax rates made municipals less attractive to insurance companies and banks. These institutions started to sell holdings resulting in massive increases in dealer inventories. To lessen their exposure, dealers were forced to cut price (yields increased). By the end of March, the intermediate bond yields were 40 basis points higher than at the beginning of the year (equivalent loss of $35@1000).

Starting the second quarter, tax exempts look more attractive than three months ago as seen in the 10-year municipal/Treasury ratio. Presently, it stands at 88%, above the long-term average and up from 82% at the end of 2017. 10-year A rated tax exempt bonds are yielding 2.95% which is equivalent to 5.78% on a pretax basis. Furthermore, given the global economic and political uncertainty along with a volatile domestic equity market, municipals should remain a centerpiece of one's portfolio allocation.

We continue to look for attractive purchases in the secondary municipal bond market. By maintaining our objective, the preservation of capital, we generally bid on bonds with intermediate maturities (7 to 12 years) coupled with a short call features (1 to 3 years). These provide yields to the call from 50 to 100 basis points higher than non-callable bonds with similar maturities as well as yields to maturity of 100 to 200 basis points higher than similar 10 year non-callable municipals. By the way, 1 basis point in yield, as in the case as above, is the difference between 2.00% to 2.50% yield to the call vs. 1.50% for a 1-3 year bond, and 4.00% to 5.00% yield to maturity vs. 2.50% to 3.00% return for a 10 year non-callable bond. The short term call provision of this investment is a major factor in preserving principal in an economic environment of rising interest rates.

Best regards,
Stephen Steglitz
Beech Hill Advisors, Inc.