Rodney's Take

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A Sure Thing in Tomorrow's Election

I'm glad I'm not a political pollster. Those people must be nervously chain-smoking cigarettes right now as they wait to see whether their model adjustments after 2016 were effective. Chances are, they will have to wait days to know for sure, as the election boards in several battleground states won't begin counting mail-in ballots before tomorrow. The process could take a while.

But no matter which candidate wins, there's at least one corner of the investment world that stands to gain: municipal bonds.

For years I've held municipal-bond closed-end funds in our investment portfolio, banking on falling rates as the economy relied on heavy Fed action, which meant interest rates near zero and market inefficiencies that kept some yields higher than they should be. I questioned my allegiance to such bonds this summer as I watched tax revenues fall across the country, putting municipal authorities at all levels at financial risk. Cities and states still must provide services, but they aren't collecting sales tax and other revenues like they have in the past. Add this issue to long-term problems like pensions and retiree healthcare benefits, and you get an ugly scenario where many entities can't pay their bills. When push comes to shove, cities and states will choose retirees and current employees over bondholders, no matter what their bond covenants and constitutions say.

We held on to our municipal bond funds through the summer, but I kept revisiting them, looking for the time to let them go. It never arrived. Instead, we got continuing negotiations over the next stimulus package, during which the White House kept moving closer to the latest Democratic proposal in the House. At around $2 trillion, there's no doubt that cities and states stand to receive at least $250 billion in new stimulus dollars, if not more.

The money won't solve the financial problems faced by Illinois, New Jersey, Kentucky, the city of Chicago, and many others, but it will let them pay their bills and put off their economic reckoning for another time. This will put the municipal bonds that we hold on solid footing, at least for the moment.

I've always thought and often have written that cities and states will somehow make their local financial woes into national problems, I just wasn't sure how it was going to happen. It seemed likely that such entities would demand a federal insurance program for their bonds so that when they defaulted, Uncle Sam (read here: national taxpayers) would have to foot the bill. Instead, we got a pandemic and tons of free cash, some of which is finding its way into city and state coffers.

While the House, Senate, and presidential administration have sparred over the level stimulus in the next bill and even over whether more stimulus is needed, those conversations are likely to fade quickly after the election. If there's one thing many politicians can agree on, it's giving away more money. With the nation looking for healing after the election, COVID-19 cases on the rise, and economists wondering how we'll grow from here with a portion of the nation still shut down, the next stimulus bill looks like a sure thing. Cities and states are standing in line, demanding their share.

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Got a question or comment? You can contact us at info@hsdent.com.