



Intra-Quarterly: The Virus of Liquidity (3/12/2020)

As the Coronavirus continues to spread across the globe, governments, businesses and schools are stepping up their containment efforts. While we can only hope that the decisions will yield positive results, the measures taken thus far are causing citizens to panic. This fear is putting further stress on the economy, financial assets, and real assets.

Virtually any asset with a price is being negatively impacted, including tax-exempt bonds. In fact, liquidity in the municipal bond market sank yesterday as portfolio managers attempted to raise cash to meet investor redemption requests. It felt like liquidity was being ripped from the market, as the bid-to-ask spread (execution costs) widened to levels rarely witnessed in the municipal bond market.

In many instances, we observed a 3 to 10 point (3-10%) bid-to-ask spread when attempting to execute sale transactions. The broker/dealer community, who was seeking to reduce their own bond exposure, was just not willing to provide "market bids". With the broker/dealer community nervous about the next round of selling pressure, particularly coming from the mutual funds, they should continue to show heavily discounted prices when they are bidding for bonds.

To us, this period of de-risking has the same "feel" as 2008 when liquidity dried up and what starts out as a financial event becomes an economic event. In fact, this morning we are hearing that several dealers are already letting "customers" know that they are not providing any liquidity at all.

As for the risk metrics in our client portfolios, such as average maturity and interest rate sensitivity (duration), they are currently at the lowest level in our firm's history. Unlike many of our peers who have been maintaining significantly longer levels of interest rate sensitivity, we feel we are in a position to take advantage of pricing anomalies. With that said, we are being patient and remain vigilant for buying opportunities as well as identifying credit risks.

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