

## **Should I be Buying Longer Municipal Bonds if Rates are Going Up?**

With interest rates still close to all-time lows, inflation numbers on the rise and the buzz in the market about the FED beginning to discuss tapering their bond purchases, there is a belief that the next move for interest rates could be higher. If we knew rates were going higher we would still like to know when, because many of us have cash to invest now. Unfortunately we don't know if or when, but most believe steps should be taken to prepare for higher rates while at the same time investing some of our excess cash in a prudent and safe manner. One way to do this is to consider municipal securities with higher coupons and shorter call dates. In this article we will discuss a few different types of alternatives that can make sense for your portfolio. *(Examples only – Rates / Details are subject to change and availability without notice)*

The Adams Co., NE has 10 years to maturity and 5 years to the call with a 2.00% coupon. Using a C-Corp tax rate of 21%, the 1.00% pre-tax YTC is adjusted to a Tax Equivalent Yield (TEY) YTC of 1.27%. Comparing this yield to the comparable 5 year TSY yield of 0.90% gives the investor a spread to TSY of 36 bps which is an attractive spread in today's market for a 5 year bond. Will this bond be called in 5 years though, or will it extend longer? Five years from now, 5 year municipal rates need to be close to the bond coupon rate of 2.0% for it to make economic sense for the issuer not to call the bond. Right now, 5 year municipal rates are in the 0.65% to 0.75% range, so rates have to go up roughly 1.30% for this bond not to be economically callable, providing the investor with 1.30% of "cushion" to protect against rising interest rates. In addition, if the bond is not called, the 4.8 point premium on the bond will have been written off over the first 5 years so after the call date, the pre-tax yield on the bond will be 2.0% or 2.53% TEY.

The Hancock Place SD MO bond has 4.7 years to the call and 14.7 years to maturity with a 3.0% coupon. If the bond is called at the call date, which is likely with an above market coupon of 3.0%, the investor will have earned a Tax Equivalent Yield (TEY) of 1.27% vs. an equivalent maturity TSY of 0.83% for a spread of 44 bps for 4.7 years. If the bond is not called the investor, at the call date, owns a 10 year callable bond at 100.00 with a 3.0% coupon. Before the bond will start trading below par, 10 year municipal rates must increase from roughly 1.25% today to 3.00%. This difference provides the investor with market value protection or a "cushion" of around 1.75%. Additionally, if the bond is not called, the 9 point premium will have been written off over the first 4.7 years so after the call date, the pre-tax yield is now the coupon of 3.0% or a TEY of 3.80%.

Even though these bonds have final maturities of 10 and 15 years respectably, it is important to consider the call dates and coupons because above market coupons provide some cushion to rising interest rates by increasing the certainty that the bonds will be called at their call dates and when combined with shorter call dates, provide the duration management many need in this environment. Coupons on some bonds in the market are as high as 4% to 5%, further increasing the likelihood that bonds will be called. The higher the coupon, the greater the chance that an investor will find themselves rooting for the bond to remain outstanding past the call date.

<u>Description</u>	<u>ST</u>	<u>Coup</u>	<u>Maturity</u>	<u>CallDt/Prc</u>	<u>Price</u>	<u>Pre-Tax</u>		<u>Tax Equivalent Yields &amp; Spreads</u>					<u>Equiv. TSY Term</u>		
						<u>YTC</u>	<u>YTM</u>	<u>YTC</u>	<u>Eq TSY to Call</u>	<u>YTC Spread</u>	<u>YTM</u>	<u>Eq TSY to Mat</u>	<u>YTM Spread</u>	<u>Years to Call</u>	<u>Years To Mat.</u>
ADAMS CO SD Cusip: 006089ES1	NE	2.00%	6/15/2031	7/14/2026 @ 100	104.865	1.00%	1.47%	1.27%	0.90%	0.36%	1.86%	1.48%	0.38%	5.07	9.99
HANCOCK PLACE SD Cusip: 410216JQ9	MO	3.00%	3/1/2036	3/1/2026 @ 100	109.132	1.00%	2.26%	1.27%	0.83%	0.44%	2.86%	1.74%	1.12%	4.70	14.70

*Data pulled on 6/21/2021 – Securities used as examples only - Details and availability are subject to change without notice*

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