Who Holds Municipal Bonds?

Municipal market watchers typically hear weekly reports about funds flow in and funds flow out. When funds flow out, the media acts as if money is leaving the municipal market. But as we know, there are two sides to every trade and longer-dated mutual funds make up only about 18% of the total $3.7 trillion outstanding municipal bond market. We parse the pre-recession 2006 holdings with the federal flow of funds June 11, 2015, Z1 report.

Diving into the numbers shows some meaningful shifts among holders. For one thing, money market mutual funds have declined by nearly a third since 2006, not a surprise given negligible short-term rates. Longer-dated mutual funds have nearly doubled over this period. Municipal exchange-traded-funds (ETFs) too, which were virtually non-existent in 2006, have nearly doubled their holdings since 2011, although they are still a relatively small slice of the overall market. Other notable movements include the following:

- Life Insurance companies, attracted by the tax-free yields at the long end of the curve, have tripled holdings since 2006.
- Broker/Dealers, which are working their way out of holding large inventories, declined nearly 60% over the period. GSE’s, too, have substantially reduced holdings.
- Depository banks, for which municipal holdings slid

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<tbody>
<tr>
<td>Household Sector</td>
<td>1,635,637</td>
<td>51%</td>
<td>1,805,739</td>
<td>49%</td>
<td>1,554,427</td>
<td>42%</td>
<td>-5.0%</td>
</tr>
<tr>
<td>Mutual Funds/ETFs</td>
<td>825,240</td>
<td>26%</td>
<td>989,641</td>
<td>27%</td>
<td>1,046,366</td>
<td>28%</td>
<td>26.8%</td>
</tr>
<tr>
<td>Money Market Mutual Funds</td>
<td>391,970</td>
<td>12%</td>
<td>357,318</td>
<td>10%</td>
<td>273,503</td>
<td>7%</td>
<td>-30.2%</td>
</tr>
<tr>
<td>Long-dated Mutual Funds</td>
<td>343,924</td>
<td>11%</td>
<td>541,172</td>
<td>15%</td>
<td>672,511</td>
<td>18%</td>
<td>95.5%</td>
</tr>
<tr>
<td>Closed-end Funds</td>
<td>89,346</td>
<td>3%</td>
<td>82,504</td>
<td>2%</td>
<td>84,621</td>
<td>2%</td>
<td>-5.3%</td>
</tr>
<tr>
<td>Municipal ETFs</td>
<td>-</td>
<td>0%</td>
<td>8,647</td>
<td>0%</td>
<td>16,001</td>
<td>0%</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>371,796</td>
<td>12%</td>
<td>452,769</td>
<td>12%</td>
<td>468,374</td>
<td>13%</td>
<td>26.0%</td>
</tr>
<tr>
<td>Property and Casualty</td>
<td>335,223</td>
<td>11%</td>
<td>330,998</td>
<td>9%</td>
<td>320,250</td>
<td>9%</td>
<td>-4.5%</td>
</tr>
<tr>
<td>Life Insurance</td>
<td>36,573</td>
<td>1%</td>
<td>121,771</td>
<td>3%</td>
<td>148,124</td>
<td>4%</td>
<td>305.0%</td>
</tr>
<tr>
<td>U.S.-Chartered Depository Institutions</td>
<td>190,065</td>
<td>6%</td>
<td>297,250</td>
<td>8%</td>
<td>465,146</td>
<td>13%</td>
<td>144.7%</td>
</tr>
<tr>
<td>State and Local Government Retirement Funds</td>
<td>1,638</td>
<td>0%</td>
<td>1,680</td>
<td>0%</td>
<td>1,978</td>
<td>0%</td>
<td>20.8%</td>
</tr>
<tr>
<td>Government-sponsored Enterprises</td>
<td>36,911</td>
<td>1%</td>
<td>21,049</td>
<td>1%</td>
<td>9,915</td>
<td>0%</td>
<td>-72.5%</td>
</tr>
<tr>
<td>Brokers and Dealers</td>
<td>50,868</td>
<td>2%</td>
<td>30,899</td>
<td>1%</td>
<td>20,629</td>
<td>1%</td>
<td>-59.4%</td>
</tr>
<tr>
<td>Rest of the World</td>
<td>34,364</td>
<td>1%</td>
<td>72,370</td>
<td>2%</td>
<td>83,663</td>
<td>2%</td>
<td>143.5%</td>
</tr>
<tr>
<td>Other</td>
<td>43,593</td>
<td>1%</td>
<td>47,968</td>
<td>1%</td>
<td>43,280</td>
<td>1%</td>
<td>-0.7%</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>3,189,292</td>
<td>100%</td>
<td>3,719,365</td>
<td>100%</td>
<td>3,694,048</td>
<td>100%</td>
<td>15.8%</td>
</tr>
</tbody>
</table>

Source: Board of Governors of the Federal Reserve System and Wells Fargo Securities, LLC

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several decades ago with tax reform and growth of the public capital markets, are ramping back, increasing holdings nearly 145% since 2006.

- International buyers have increased their holdings 144% over the period. These investors find municipal securities attractive when they are cheap relative to Treasuries, and the spread effectively overcomes the U.S. tax code. Episodes of “flight to quality” attract international buyers (Greece, China, and who would have thought, the rally following the U.S. rating downgrade).

Finally, we would not be worth our analytical salt if we did not comment on the data. The Federal Reserve (sadly) includes both non-profit organizations and hedge funds in the Household category. We suspect that the holdings of non-profits are negligible, but those of hedge funds and other alternative investors are not negligible relative to other categories.

The best we could come up with was a Bond Buyer discussion from Nov. 13, 2013, that mentioned $166 billion. That figure included data for 116 hedge funds in North America. Other fixed income could be mixed into that number. On the other hand, certain large debt-focused hedge funds were excluded from the count. These investments have likely grown since 2013, given the various distressed issuers (notably Puerto Rico) in the market.

So let’s say hedge funds (and a small smatter of non-profit institutional holdings) represent $200 billion of the $1.55 trillion Household sector. Lets also assume these investors were minor participants in 2011. This would mean that the “true” individual retail investor (i.e. in contrast to individuals who invest in mutual funds) has reduced holdings about 25% since 2011. Such a reduction in retail holdings makes sense given the 2013 “taper tantrum”, the Detroit bankruptcy filing and the awareness of Puerto Rico’s severe fiscal problems since that time.
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July 27, 2015

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Global Head of Research, Economics & Strategy

Diane Schumaker-Krieg, Managing Director, Global Head of Research, Economics & Strategy
diane.schumaker@wellsfargo.com (704) 410-1801
(212) 214-5070

Municipal Securities Research

Natalie Cohen, Managing Director Head of Municipal Research
natalie.cohen@wellsfargo.com (212) 214-8014

George Huang, Director Healthcare
george.huang@wellsfargo.com (212) 214-5061

Randall Gerardes, Vice President Infrastructure
randall.gerardes@wellsfargo.com (212) 214-5026

Roy Eappen, Associate General Municipal Analyst
roy.eappen@wellsfargo.com (212) 214-8045

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