REUTERS

Reassuring clients during municipal meltdowns

By Jennifer Hoyt Cummings (excerpt)
August 2, 2013

NEW YORK (Reuters) - While U.S. municipal bond investors wait to see how Detroit's bankruptcy filing plays out, advisers should be calming them while taking a hard look at their portfolios.

Some prognosticators say that if the bankruptcy court treats Detroit kindly by allowing it to shed a lot of its liabilities, other troubled cities will follow its lead.

Others disagree, saying Detroit's Chapter 9 bankruptcy, filed on July 18, may drag on for years and lead other cities to think such a move is not worth the trouble.

"This will be precedent-setting for the municipal bond market," said David Kudla, chief executive officer of Mainstay Capital Management LLC, which is based 60 miles outside of Detroit.

While things are in limbo, many investors are taking their money out of U.S. municipal bond funds. They withdrew $2.24 billion in the week ended on Wednesday, extending the funds' outflow streak to 10 weeks, according to Lipper, a Thomson Reuters company.

These skittish investors may be acting prematurely, many municipal bond experts say, so it is up to advisers to give clients perspective while also reviewing their holdings to make sure there will not be any surprises.…

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Remind clients that municipal bonds have very low default rates. A May report by Moody's showed that the average 10-year default rate on municipal bonds was 0.12 percent, compared with 11.8 percent on corporate bonds. And of the 7,500 municipalities with bonds rated by Moody's, fewer than 40 are below investment grade.

Overall state tax collections are still weak, but they had risen for 13 consecutive quarters through the end of March, according to The Nelson A. Rockefeller Institute of Government. Housing prices are also on the rise, a boon for property taxes. …