General Commentary

The escalating US/Iran war set the tone this week, with its reach into global oil flows driving a sharp selloff in rates. Brent crude climbed from around $88 to a Thursday peak just above $100 after Iran-backed Houthis attacked two Saudi tankers in the Red Sea, threatening a key export route days after floating a broader maritime blockade. Treasuries sold off through Thursday as the oil spike revived inflation concerns, led by the front end. The 2y jumped 15bps while the 10y climbed 13bps to break through its 52-week high. Fed Funds futures turned notably more hawkish, pricing a 38% chance of a hike next week against 14% a week ago, with more than 100% probability of a hike by September and two hikes by January. Friday offered some relief, as a report that Pakistan was exploring a revival of US/Iran negotiations pushed oil off its highs toward $96 before it settled back near $98, letting stocks and Treasuries recover part of the week's losses.

IG Munis

Against a heavy Treasury selloff, the AAA MMD curve fared worse still, cutting 18-22bps with the belly cheapening the most. Several forces converged at once. Cash had dwindled into a light mid-July reinvestment window, new issue supply stayed relentless, and secondary selling picked up. According to JPM, weekly bid lists rose 42%, with Wednesday's volumes hitting $4bn, the highest in over a year. Dealers absorbed much of that paper onto their own balance sheets rather than passing it to customers. Lipper reported $174mn of headline inflows, a 14th straight positive week, but the tone was clearly turning, as open-end funds slipped into net outflows on the week and the daily tally showing 3 straight days of outflows. The new issue market bore the strain most visibly, as deals were forced to widen repeatedly to clear, some moved to day-to-day status, and refunding transactions were pulled as savings thresholds slipped. The $1.5bn Aa1/AAA NYC TFA deal went into three order periods, widening each time to reach clearing spreads out to +50 in the belly. By Thursday the selloff had cheapened valuations enough that 5-10y ratios were screening fair value to cheap against a 1y lookback, though still rich by longer-term standards. We think the reset is healthy, but with munis still far from cheap to historical levels and the Fed a wildcard next week, we are inclined to stay patient before putting cash back to work aggressively.

HY Munis

The HY market held in better than the high grade selloff would suggest, despite mutual funds recording their first outflows in 16 weeks. Even as 30y AAA MMD yields climbed 19bps, long duration benchmark names widened only 11-13bps, leaving HY index spreads to IG at their tightest of the year and less than 10bps from the tightest level of the past decade, a mark briefly touched during last year's tariff tantrum. Buckeye Tobacco was the clearest example, widening to 6.95% Thursday morning as holders de-risked into the weaker tape before clawing back to close at 6.89%, off just 13bps. Cofina followed a similar path, printing as wide as 5.27% before recovering to 5.21% by Friday. Away from the most liquid benchmark names, conditions were thinner. According to JPM, HY bid lists rose 32% on the week. Dealers reported plenty of bonds where they were high bid, yet the holder did not trade nor price them, with names that did clear trading well wide of evaluations. A BB rated NY college print changed hands around 7.25% against a 6.78% eval, and a nonrated NC hotel and convention center traded at 6% versus a 5.85% eval. New issue was quiet, but next week's $612mm nonrated NJ behavioral health deal will test how much risk appetite remains. If outflows persist and holders are pushed into forced selling, dislocations will follow. But a single week of modest weakness likely has done little to change the supply/demand imbalance, and it would take a more sustained stretch of weakness before the dynamic shifts toward a buyer's market.

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Market Commentary

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