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WELLS FARGO SECURITIES

Municipal Securities Research

Municipal Commentary

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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

Holders of Municipal Securities and Loans
Millions of dollars outstanding at end of period; not seasonally adjusted

	2006		2011		2015Q1		
Sector	**Value**	**Percent**	**Value**	**Percent**	**Value**	**Percent**	**∆2006-2015**
Household Sector	1,635,637	51%	1,805,739	49%	1,554,427	42%	-5.0%
Mutual Funds/ETFs	825,240	26%	989,641	27%	1,046,636	28%	26.8%
Money Market Mutual Funds	391,970	12%	357,318	10%	273,503	7%	-30.2%
Long-dated Mutual Funds	343,924	11%	541,172	15%	672,511	18%	95.5%
Closed-end Funds	89,346	3%	82,504	2%	84,621	2%	-5.3%
Municipal ETFs	-	0%	8,647	0%	16,001	0%	
Insurance	371,796	12%	452,769	12%	468,374	13%	26.0%
Property and Casualty	335,223	11%	330,998	9%	320,250	9%	-4.5%
Life Insurance	36,573	1%	121,771	3%	148,124	4%	305.0%
U.S.-Chartered Depository Institutions	190,065	6%	297,250	8%	465,146	13%	144.7%
State and Local Government Retirement Funds	1,638	0%	1,680	0%	1,978	0%	20.8%
Government-sponsored Enterprises	36,091	1%	21,049	1%	9,915	0%	-72.5%
Brokers and Dealers	50,868	2%	30,899	1%	20,629	1%	-59.4%
Rest of the World	34,364	1%	72,370	2%	83,663	2%	143.5%
Other	43,593	1%	47,968	1%	43,280	1%	-0.7%
Total Assets	3,189,292	100%	3,719,365	100%	3,694,048	100%	15.8%

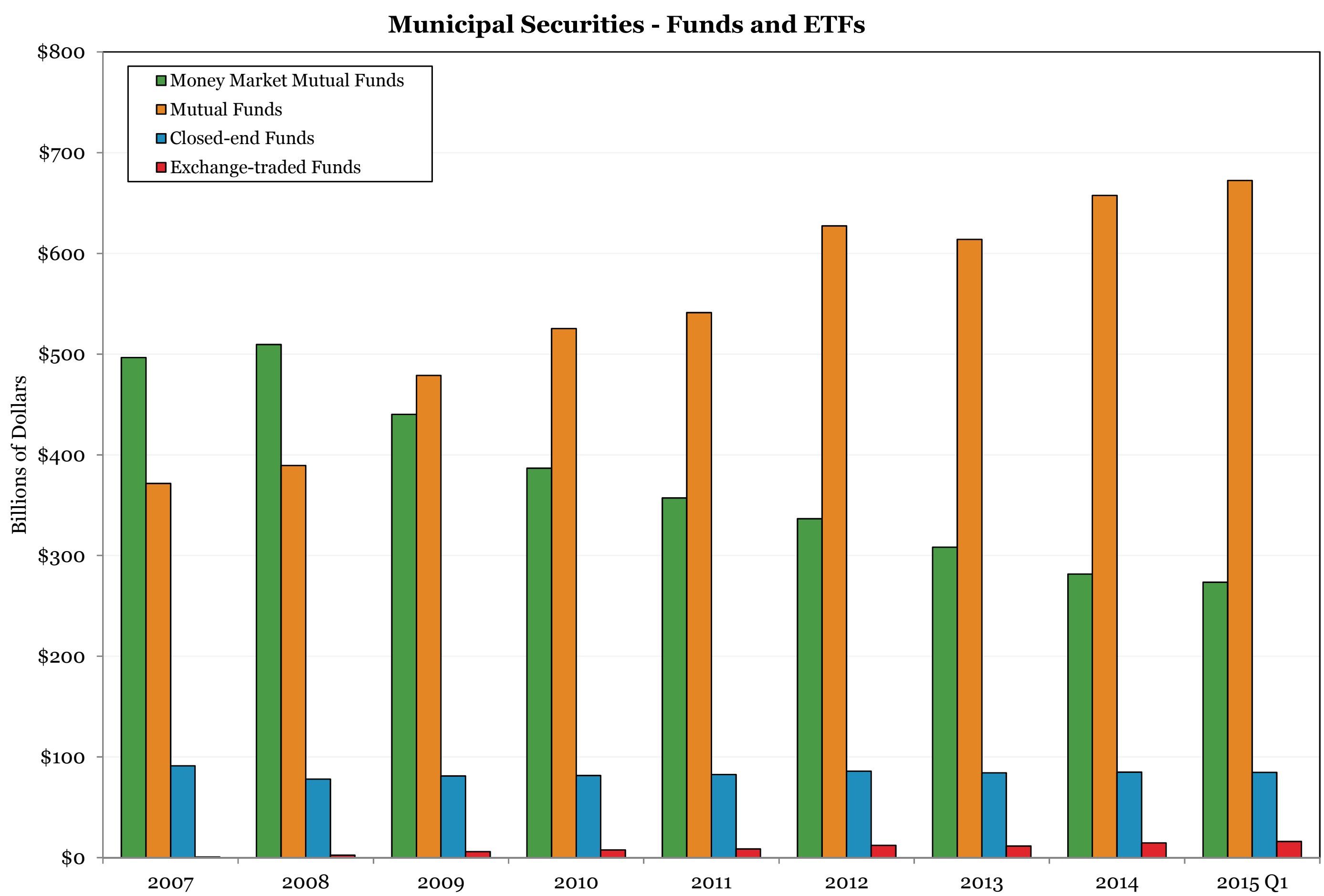
Source: Board of Governors of the Federal Reserve System and Wells Fargo Securities, LLC several decades ago with tax reform and growth of the public capital markets, are ramping back, increasing holdings nearly 145% since 2006.

- 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.



Billions of dollars outstanding at end of period; not seasonally adjusted.
Source: Board of Governors of the Federal Reserve System and Wells Fargo Securities, LLC

Additional information is available on request.

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