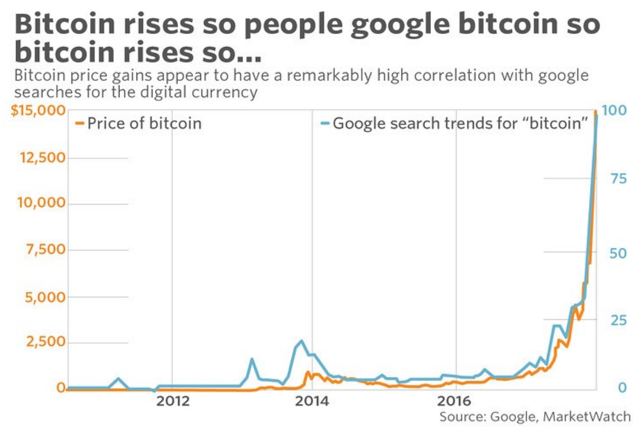
Stonebridge Market Wrap

December 8, 2017

For the week ending December 8, 2017

This past week was kind of dull. Dull unless you are watching Bitcoin. The amount of speculation surrounding cryptocurrencies such as Bitcoin puts speculation into a new light entirely. The price that began the week at $11,500 soared to $19,600 on Thursday before settling on Friday at $15,150. This is not a truly functioning market. The exchanges have been beset with hacks and DDoS attacks, exposing the investor to wild swings. Being entirely unregulated means that there is no supervision on trading and no recourse if your coins are stolen or you are unable to trade them during a melt down. There is a coming ability to trade bitcoins on the futures market which will be odd since you will have a regulated market trading something that is entirely unregulated. 2017 began with the coins trading at about $1000 and it didn't break $5000 until early October. This makes no sense and I fear that some people are going to lose a lot of money in this mania. The little guys, grandmothers, aunts and uncles are in it now so watch out.



David A. Eckenrode
Director of Equity Management

Key Economic Releases for the coming week:

Tuesday, December 12th:
- PPI; .4% expected
- Core PPI; .3% expected

Wednesday, December 13th:
- CPI; .3% expected
- Core CPI; .2% expected

Thursday, December 14th:
- Retail Sales; .3% expected

Friday, December 15th:
- Capacity Utilization; 77.1% expected
- Industrial Production; .4% expected

Index & Price Changes for week ending 12/8/17	
DJIA– 24,329.16	Rose 771.17 points
NASDAQ– 6889.16	Fell 49.08 points
S&P 500– 2651.50	Rose 49.08 points
S&P Small Cap 600– 928.11	Rose 2.86 points
90 Day T Bill– 1.28%	Yield Rose .02%
2 yr TSY– 1.79%	Yield Rose .01%
5 yr TSY– 2.14%	Yield Rose .02%
10 yr TSY– 2.38%	Yield Rose .02%
30 yr TSY– 2.76%	Yield Was Unchanged
Oil- $ 57.43*	Fell $.95 per barrel
Gold- $ 1249.60*	Fell $42.90 per oz.
Unleaded Gasoline-$1.72*	Fell $.02 per gallon
Euro- $ 1.1766	Fell $.0131 against the $

** Wholesale price for NY Mercantile Exchange traded contract*

2550 University Avenue West, Suite 180 South, St. Paul, MN 55114
830 East Front Street, Suite 300 Traverse City, MI 49686
www.stonebridgecap.com
Fax: 651-251-1010 Phone: 651-251-1000
Fax: 231-933-0628 Phone: 231-933-0320
Toll-free: 800-317-1127

Will the Tax Reform Bill Affect Municipal Bonds?

We have had many questions regarding how the Tax Reform Plan coming out of Congress may affect the Municipal bond market. We clearly do not have a crystal ball, and are still hoping to get a better handle on what might pass, and not jump ahead of ourselves too much. With that being said, here are a few of our thoughts.

In short, the tax ramifications on the Municipal bond market could be substantial. The most glaring change would be on bonds in high income tax states. The bonds in these states will see an increase in demand as the State and local income tax paid on out of state bonds would no longer be deductible on federal taxes. As an example, if a MN bond yield was 2%, then a MN resident would need to be able to buy a non- MN bond at 2.22% to make up for the 9.875% State tax on that income. Currently, with State income taxes as an allowable deduction on Federal income, the MN investor would only have to find an out of state bond that yielded 2.13% to offset the state tax. This yield difference becomes much more substantial at higher interest rates. At a 4% yield the MN investor would need to find an out of state bond that yields 47 basis points higher (4.47%). The likely scenario is that bonds in high income tax states like MN, NY and CA will see a substantial increase in demand which would lead to lower yields (higher prices) for the bonds being issued in these states. This could also have the effect of allowing rates to go up in non-income tax states as the bond yields could adjust to make up for the differential in demand in those states.

We also believe that demand for muni bonds will rise from the individual investors, as individuals move to buy more munis to avoid taxes as well as buy up as many bonds as possible in case Congress ever would decide to take away the exemption all together. The elimination of private activity bonds (which was in the House bill) could fundamentally alter the supply in the market going forward and increase borrowing costs for many local issuers. Private activity bonds are roughly 20% of current issuers. We do not believe that they will do this, as it will deeply harm the municipalities that benefit from borrowing at tax-exempt yields. We also are certain that the removal of the tax exemption would only be on new issues and that the exemption will remain on outstanding issues.

The other big influence on muni yields will be demand from corporations. Insurance companies and banks are the largest institutional buyers of muni bonds (other than mutual funds which are mainly invested in by individuals) and hold roughly 25% of outstanding muni bonds. The lower corporate tax rate will have an effect on their need for TE bonds going forward. Corporations tend to balance TE and taxable debt in their portfolios which will shift more to taxable bonds which will lessen demand from that sector of the market. This would in turn increase the yields on munis.

Supply and demand as always will determine the yields for munis. Given the corporate tax cuts, there will be changes in the demand side of that equation. It is our belief that the lessening demand from corporations will be offset (partially but not entirely) by demand from individuals. The unknown is the change on supply side, and we are watching that very closely.

Due to the uncertainty in the tax reform act, municipal issuers are rushing to refund outstanding issues which is significantly increasing the supply coming to market at this time. We have seen this supply increase yields in the current market, and we are busy taking advantage of this anomaly.

What all of this means is that we think Municipal bonds still hold relative value for individuals, and as always we will look nationally for the best value, no matter what state in which our clients reside.

Again, it is important to point out that these are initial thoughts, that well could change as congress pounds out the details.

Heidi L. Hukriede, CFA
Founder & Portfolio Manager

2550 University Avenue West, Suite 180 South, St. Paul, MN 55114
830 East Front Street, Suite 300 Traverse City, MI 49686
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