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THE DIS-UNITED STATES OF AMERICA?

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State general obligation bonds offer the safest returns in the municipal bond industry. Statistically, the U.S. is in its 8th year of economic recovery. In times like this, all boats usually rise with the tide. But in 2016 alone, Standard and Poor's raised only two state ratings (Hawaii & Tennessee), but downgraded 8 states (Alaska, Connecticut, Illinois, Kansas, New Jersey, New Mexico, North Dakota and West Virginia). That's a decline of 16% of state ratings, when the average downgrade rate for all municipal bonds is approximately 5% per year.

In the past, state bond ratings were usually downgraded after the official date assigned to a recession. The lag in downgrades can be attributed to the tax collection calendars of states: the largest variable comes in April, near the end of the fiscal year, when tax returns show the true state of income tax collections and refunds. In a slow economy, states underestimate income taxes, leading to large deficits for that fiscal year. Based on preliminary results in the 8 states cited by S&P, I believe 2017 may be a challenging year for all state financial operations.

Downgrades and recessions are inextricably tied. The problem right now is that state ratings are dropping down before an official recession has been declared.

New Jersey has been under continual stress since they lost their "AAA "rating in 1991. Connecticut's rating is historically volatile, depending on the ebb and flow of expansion/recession. California's rating volatility is connected with its corporate income taxes, and Illinois has followed the same pattern as Connecticut, except that this time its deficits and unfunded pension liabilities have put them at the bottom of the state rating ladder.

About the Author

RICHARD P. LARKIN, Stoever Glass & Co., Inc.

Richard Larkin, a recognized 40 year industry veteran, has joined SG & Co. as Director of Municipal Credit Analysis. Mr. Larkin began his career in credit rating analysis at Standard & Poor's in 1975. After rising through the ranks in various analytical and management positions, Dick left S&P as its Chief Municipal Rating Officer, responsible for municipal rating policy, practices, governance and criteria. In 1998, Mr. Larkin joined Fitch Ratings as Chairman of its Public Finance Criteria Committee.

"Dick will be a unique resource to Stoever Glass' municipal clients. His knowledge in specific issues and areas of the municipal bond industry will aid our representatives and their clients in making educated decisions, in a sector where this type of research is unique," said Roland Stoever of Stoever Glass.

Disclosures: