Jeff Davis, CFA, is a veteran bank analyst. The views and opinions expressed in this piece are those of the author and do not necessarily represent the views of S&P Global Market Intelligence or Mercer Capital, where he is the managing director of the financial institutions group.

It is the beginning of the year, which means Wall Street has published most of its prognostications. This year, the consensus appears to be rates will move higher, though maybe long-term rates not so much, and volatility in equity markets will increase with prices trending higher. It is a similar consensus as a year ago. But few called what transpired in 2017 in which equity prices rose sharply with little volatility, while the yield curve flattened from a combination of rising short-term rates and easing long-term rates. My prognostication is a cop-out: I do not know what will happen in 2018.

One of the more dramatic "calls" that I recall occurred seven years ago on "60 Minutes" when Meredith Whitney predicted there would be 50 to 100 sizable municipal defaults totaling "hundreds of billions" of dollars. Later in the interview, she said it would be something to worry about within the next 12 months. I put "call" in quotes because the editing of an extensive interview by the producers left a clear impression the defaults would begin to unfold in 2011. The only sizable default in 2011 was Jefferson County, Ala. Detroit would follow in 2013. When I watched the broadcast I took her call as a coming bloodbath in 2011, but upon listening to a replay, I picked up on the distinction between hundreds of billions of coming defaults and the visibility of coming defaults increasing within the next 12 months. Subtle distinction or not, the interview caused a year-end sell-off as retail investors dumped their muni bonds. Of course, the other side of the trade is those who bought the dip looked savvy by year-end 2011 when a tidal wave of defaults did not materialize.

I bet there are a lot of "60 Minutes" interviewees like Whitney who felt they were bamboozled once the edited version of their interview aired. The editing and/or Whitney's choice of words without any caveats resulted in the violation of a basic Wall Street adage: Tell them how much or when, but never both if possible. Either hundreds of billions of defaults will occur, or the visibility of the defaults will come into focus next year, but not what the world heard, in which bankruptcy attorneys were racing to courthouses to start filing.

As a prognostication that was taken to mean the next 12 months, Whitney's call was a flop that invited ridicule. Nonetheless, I liked the call then, and now, because I believe she is right. I would not be surprised if the amount of defaults in time exceeds the amount she predicted unless municipal and state employees and pensioners agree to lower payouts. Good luck with that, although it is the fault of politicians and bureaucrats who made the financial promises and not that of the current employees and retirees.

The issue is a slow-motion train wreck as liabilities accrue each year while many plan sponsors have not and cannot make adequate contributions to meaningfully close the gap. The tip-of-the-spear today includes Puerto Rico, Illinois, Hartford and Chicago. Even the prosperous growth market of Dallas faces financial difficulties because of a run on the Dallas Police and Fire Pension Fund as employees elected to take early retirement with lump-sum contributions due to the fund's precarious financial position. A similar issue exists in Kentucky, where the state's pension is woefully underfunded.

Estimates vary based upon actuarial assumptions, but according to an estimate by the Actuarial Standards Board's Pension Task Force the unfunded pension liability of local and state governments was $5 trillion in 2016. Pay-as-you-go healthcare benefits are another unfunded obligation that is large. In comparison, there is about $3 trillion of outstanding local and state government debt, according to the Federal Reserve's Z.1 statistical analysis.

The issue will get worse for some Blue states that are experiencing a slow drain of their more productive citizens to
lower-cost Red states that are mostly in the interior of the country, plus the Carolinas and Florida. Whitney predicted this, too, in her 2013 book *Fate of the States* in which she argued that the lower-cost interior of the country will see population and economic growth at the expense of the high-cost coastal states.

For those of you who live in places like Denver, Austin, Boise and Raleigh, Whitney’s demographic call does not seem big at all. The population shift has been obvious for years before anyone contemplated the impact that limitation on state and local tax deductions would have as codified in the December tax bill. I have watched it play out over the years from Nashville, where transplants from California, Chicago and the New York tri-states area are common.

Like Florida and Texas, Tennessee has no state income tax, while the once 6% Hall tax on investment income has been reduced to 4% this year and is scheduled to be completely phased out by 2022. More financial services firms and retirees will relocate to Tennessee because of the change in the law. And as an aside, Tennessee’s pension was 95% funded in 2015, according to analysis by Pew Charitable Trusts.

Whitney got the municipal debt call right. The investing community would recognize that if “in the next 12 months” had not been uttered. While much of Wall Street's prognosticating is about what will occur in the next year, big investable themes play out over years, if not decades, like the impact of falling interest rates that occurred from the early 1980s until recently. Municipal bankruptcies and restructurings of state obligations (states technically cannot declare bankruptcy) will play out over the next couple of decades.

As for bank investors, my call is that banks as a group will avoid getting burned badly because the credit issue is gradually emerging and most banks will avoid emerging problem municipal credits. Nonetheless, investors will have to pay attention to call reports that may give clues to credit problems that are not obvious until one day the market decides the bonds are not so creditworthy.

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Jeff K. Davis, Managing Director of Mercer Capital's Financial Institutions Group, is a regular contributor to SNL Financial. He can be reached at jeffdavis@mercercapital.com or 615.345.0350.