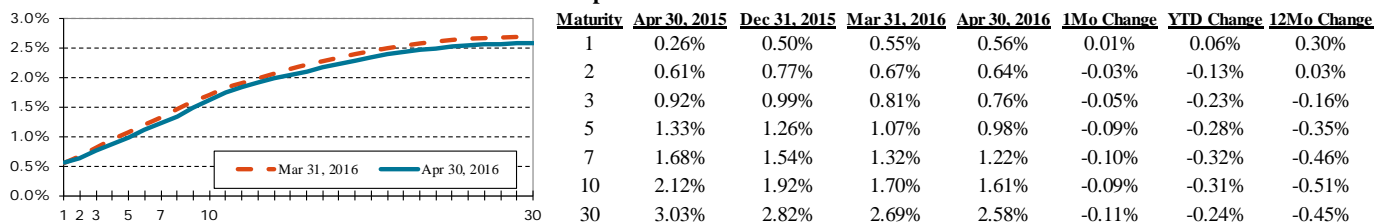


Baird Advisors
Municipal Fixed Income Market Comments
April 2016

Favorable Supply/Demand Backdrop

In April, the municipal market continued its recent trend toward lower rates and a flatter yield curve despite a modest rise in Treasury yields last month. Municipals benefited from a favorable technical backdrop; supply was relatively light while demand remained strong. April's new issue volume was 21% below year ago levels. YTD total supply is 14% off last year's pace. The disappointing volume is due to a somewhat surprising decline in refunding activity given the low nominal yield levels currently available. At the same time, demand for municipals has remained consistently positive. YTD municipal fund inflows total \$19.5B, already ahead of the \$13B that came in for all of 2015. The heaviest demand has been for intermediate and long-term funds which helped to push rates lower across those curve segments. Short-term rates were little changed as the Fed outlook remained stable following the April FOMC meeting. The diverging yield curve activity led to 12 bps of flattening between the 1 and 30 year maturity segments last month.

AAA Municipal Yields



Credit Updates

Congressional leaders were unable to reach agreement on a workable fiscal solution for Puerto Rico prior to the Government Development Bank (GDB) debt payment due on May 1, leading to a default on approximately \$370 million bonds. Anticipating a delay in Congress and running short on resources, Puerto Rico's legislature last month granted Governor Padilla the power to implement a debt moratorium. Given the authority to decide what debt gets paid, and when it gets paid, he elected to withhold payment on the GDB bonds. Congress is working to finalize a bill, the Puerto Rico Oversight, Management, and Economic Stability Act (PROMESA), which would establish a federal financial oversight board. Getting broad agreement on the provisions of the bill has been a challenge to say nothing of the very complicated task the oversight board would face. The next target date for a Congressional solution is July 1st when a collective \$2B of Puerto Rico debt payments are due.

Back on the mainland, the municipal credit backdrop remains strong. The U.S. Census bureau reported that state and local tax revenue grew 5.5% in 4Q15 from the prior year. This is the 17th consecutive quarterly increase and the pace exceeded the 3.0% average growth rate in tax revenues since the end of the recession in 2Q09. Individual income taxes, which represent roughly one-half of all state tax revenues, are now 14% above pre-recession levels (4Q07). Property taxes, which represent approximately 80% of local tax revenues, also continue to improve thanks to the strength in home values. Total property tax revenues are 8% ahead of the level in 4Q07. That said, we expect the pace of state and local tax revenue growth to moderate in coming quarters, reflecting the recent deceleration in U.S. GDP growth and slower housing price increases nationally.

Positive Trend Continues

Absolute returns were positive across all segments of the yield curve and market sectors last month. Yield curve positioning was very important as longer maturities outperformed the short end by a significant 80 bps in total return in April. The pre-refunded market sector lagged due to a shorter average duration than other sectors and the closer relationship to Treasuries. Beyond this, there was little difference between GO's and revenue bonds for the month. From a credit perspective, lower-rated investment grade credits (A and BBB) outperformed, while high yield returns were only marginally positive.

Total Returns of Selected Barclays Municipal Indices and Subsectors

<u>Barclays Index/Sector</u>	<u>Apr</u>	<u>3Mo</u>	<u>12Mo</u>	<u>Barclays Quality</u>	<u>Apr</u>	<u>3Mo</u>	<u>12Mo</u>
Municipal Bond Index	0.74%	1.21%	5.29%	AAA	0.65%	0.99%	4.64%
General Obligation bonds	0.71%	1.03%	5.02%	AA	0.69%	1.08%	5.03%
Revenue bonds	0.80%	1.39%	5.80%	A	0.86%	1.52%	6.11%
Prerefunded bonds	0.18%	0.26%	1.62%	BBB	0.79%	1.62%	5.64%
Long maturities (22+ yrs.)	1.05%	2.12%	7.30%	High Yield	0.10%	1.18%	2.87%
Intermediate maturities (1 - 17 yrs.)	0.60%	0.87%	4.47%	HY, ex-Puerto Rico	0.11%	0.81%	6.60%
Short maturities (1 - 5 yrs.)	0.25%	0.33%	1.80%				

Disclosures

This is not a complete analysis of every material fact regarding any company, industry or security. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

Fixed income is generally considered to be a more conservative investment than stocks, but bonds and other fixed income investments still carry a variety of risks such as interest rate risk, credit risk, inflation risk, and liquidity risk. In a rising interest rate environment, the value of fixed-income securities generally decline and conversely, in a falling interest rate environment, the value of fixed-income securities generally increase. High yield securities may be subject to heightened market, interest rate or credit risk and should not be purchased solely because of the stated yield.

Indices are unmanaged, and are not available for direct investment. *Past performance is not a guarantee of future results.*

The Barclays Municipal Bond Index is a broad-based, total-return index. The bonds are all investment-grade, tax-exempt, and fixed-rate securities with long-term maturities (greater than 2 years). They are selected from issues larger than \$50 million. The components listed below the Municipal Bond Index (long maturities, intermediate maturities, short maturities, prefunded bonds, general obligation bonds and revenue bonds) are subsectors of the Barclays Municipal Bond Index and do not represent separate indices.

The Barclays High Yield Municipal Index includes bonds with a par value of at least \$3 million and must be issued as part of a transaction of at least \$20 million. The maximum rating for inclusion is Ba1/BB+/BB+ using the middle rating.

For more information about the Barclays Municipal Bond Index or Barclays High Yield Municipal Index, please visit https://index.barcap.com/Home/Guides_and_Factsheets.

Municipal securities investments are not appropriate for all investors, especially those taxed at lower rates. The alternative minimum tax (AMT) may be applicable, even for securities identified as tax exempt. Past performance is not a guarantee of future results.