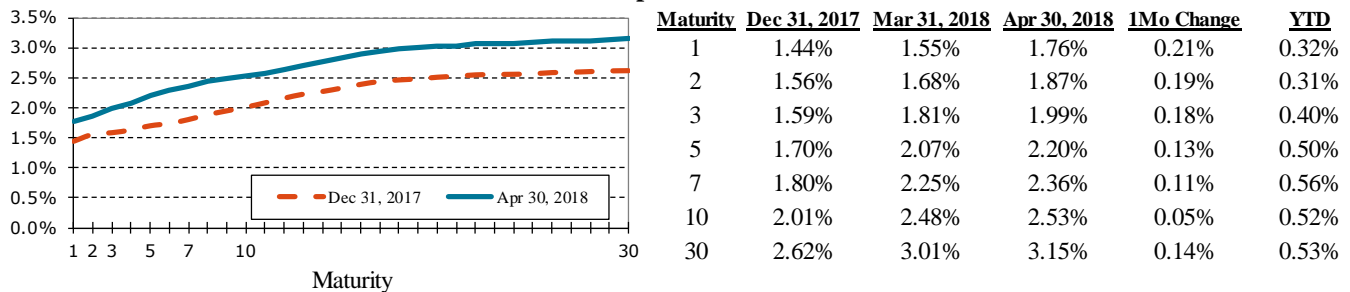


Baird Advisors
Municipal Fixed Income Market Commentary
April 2018

Yields Rise, Supply Remains Light

Rising yields in the Treasury market put upward pressure on tax-free yields last month, but not uniformly across the curve. While the short and long ends of the tax free curve moved up in tandem with Treasury yields, intermediate municipal yields were more resilient thanks to light supply. The 10-year tax-free yield, for example, rose just 5 bps compared to a 19 bps increase in the same maturity Treasury yield. Despite issuance for new projects being up 11% this year relative to last, which is an encouraging sign given the significant infrastructure needs of state and local governments, this only partially offsets the complete absence of supply from advanced refunding issues which were eliminated by the Tax Cuts and Jobs Act passed in December. As a result, total YTD issuance is 23% off the 2017 pace with little near-term expectation of meaningful improvement. Demand for municipals was mixed as seasonal outflows to meet April tax payments occurred as anticipated. Nonetheless, flows into long-term and high yield municipal funds were positive in the month as investors continue to be drawn to the relatively attractive valuations of the tax free market and the still sufficient additional yield available in lower tier credits.

AAA Municipal Yields



Credit and Other Municipal Developments

- The nation's infrastructure needs surfaced once again as Mississippi's governor issued an emergency order to shut down 102 bridges across the state last month. The Federal Transportation Administration threatened to withhold federal funds if the bridges weren't closed. Mississippi is not alone – as of the end of 2017 54,560 (9%) of the nation's 615,002 bridges were deemed "structurally deficient" by the Federal Highway Administration.
- The U.S. Supreme Court heard oral arguments in a case (*South Dakota v. Wayfair*) that puts in play an estimated \$100B of new state and local e-commerce sales tax revenue over the next decade. If South Dakota wins, all states would have the ability to collect sales taxes from out-of-state retailers that send merchandise to their residents.
- Moody's updated analysis of the nonprofit healthcare sector highlighted the ongoing challenges hospitals face in an era of aging demographics and declining reimbursement rates. Operating cash flow margins slipped to a still solid 8.1% in fiscal year 2017 from 9.5% the prior year as revenues fell more than expenses. More strategic partnerships and mergers are likely as hospital managers continue to seek efficiencies in healthcare delivery.
- New York was the first state to enact workarounds to the \$10,000 cap on state and local tax deductions. New York now allows charitable trusts to accept tax deductible payments in lieu of taxes and employers to implement a 5% payroll tax to pay some of an employee's state income tax. Eight other states (CA, IL, MD, NE, NJ, RI, VA, WA) are weighing similar tax law changes. So far, neither the U.S. Treasury nor the IRS has responded to a request for comment.

Rate Pressure Pulled Returns Negative

Rising yields in April pulled returns into negative territory across the municipal market. Longer maturities underperformed other maturity segments. Only High Yield municipals produced a positive return, helped by thin new supply and solid demand.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

<u>Bloomberg Barclays Index/Sector</u>	<u>April</u>	<u>YTD</u>	<u>12Mo</u>	<u>Bloomberg Barclays Quality</u>	<u>April</u>	<u>YTD</u>	<u>12Mo</u>
Municipal Bond Index	-0.36%	-1.46%	1.56%	AAA	-0.42%	-1.61%	0.62%
General Obligation bonds	-0.38%	-1.57%	1.23%	AA	-0.37%	-1.48%	1.16%
Revenue bonds	-0.36%	-1.55%	1.88%	A	-0.33%	-1.41%	2.10%
Prerefunded bonds	-0.25%	-0.29%	-0.21%	BBB	-0.23%	-1.23%	4.46%
Long maturities (22+ yrs.)	-0.64%	-2.19%	3.25%	High Yield	0.45%	1.03%	5.79%
Intermediate maturities (1 - 17 yrs.)	-0.27%	-1.17%	0.82%	HY, ex-Puerto Rico	0.40%	0.63%	7.14%
Short maturities (1 - 5 yrs.)	-0.25%	-0.15%	-0.07%				

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 Bloomberg 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 Bloomberg Barclays Municipal Bond Index and do not represent separate indices.

The Bloomberg 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 Bloomberg Barclays Municipal Bond Index or Bloomberg 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.

Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest). Investment grade investments are those rated from highest down to BBB- or Baa3.