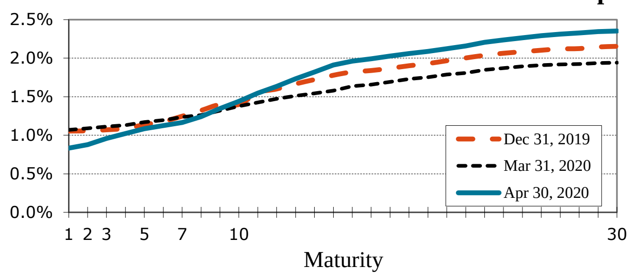
Baird Advisors
Municipal Fixed Income Market Commentary
April 2020

Curve Steepens as Municipal Market Begins to Stabilize

The municipal market gradually found its footing last month following the unprecedented volatility in March. Although tax-free funds continued to experience outflows, losing over $15B in April following the record $32B of redemptions in March, the market still absorbed nearly $24B of new debt. Supply was down 15% from April of last year, but up 30% from March, signaling an improving market tone. The tax-free curve steepened sharply as short-term rates fell 24 bps while long-end rates rose 27 bps, each segment pivoting around unchanged yields in the 10-Yr range. The decline in short-term fixed rates was led by a collapse in the SIMFA floating rate which fell from 4.71% to 0.22% thanks to the presence of a new Fed creation, the Municipal Liquidity Facility (MLF). The MLF allows the Fed to purchase debt directly from states, cities over 250,000 in population (there are 86) and counties over 500,000 (119). The Fed's facility is open until year end and will lend for a term of up to three years, assuming each qualifying municipality had an investment grade rating on April 8th. Although the Fed was clear in specifying that municipalities should first go to the public market for their funding needs, simply having the Fed as a backstop lender positively impacted market liquidity.

AAA Municipal Yields



Maturity	12/31/19	3/31/20	4/30/20	1Mo Δ	YTD Δ	Q1 Δ
1	1.06%	1.07%	0.83%	-0.24%	-0.23%	0.01%
2	1.06%	1.09%	0.88%	-0.21%	-0.18%	0.03%
3	1.07%	1.12%	0.96%	-0.16%	-0.11%	0.05%
5	1.14%	1.17%	1.09%	-0.08%	-0.05%	0.03%
7	1.25%	1.28%	1.17%	-0.11%	-0.08%	0.03%
10	1.48%	1.44%	1.44%	0.00%	-0.04%	-0.04%
30	2.15%	2.08%	2.35%	0.27%	0.20%	-0.07%

Credit Concerns Grow, Political Process Begins on Additional Fiscal Support for Municipalities

Adding to the growing concerns over municipal credit, Senate Majority Leader Mitch McConnell caused unnecessary additional anxiety last month. Responding to a question on a radio talk show, he spoke in favor of allowing states to file bankruptcy rather than have the federal government bail out municipalities that were poorly managed prior to the economic stop. He later recanted, saying he would support additional funds for municipalities (with certain conditions), but that his preference was to "pause" and allow the funds already allotted in the CARES Act, and other measures, time to work. On the other side of the political spectrum, House Speaker Nancy Pelosi suggested an additional $1 trillion of fiscal support is needed for state and local governments. Supporting her views, the National Governors Association estimates states will need $500B and a coalition of National Cities and Counties suggests an additional $250B will be needed to fill growing budget gaps. While the political process unfolds, the market does expect that additional fiscal support, perhaps in the form of a "CARES Act 2," will eventually come together. Moody's estimates that states will experience a fiscal shock of approximately 20% of 2019 general fund expenditures between the current and next fiscal year, roughly twice the revenue drawdown during the Great Recession. Fortunately, states had an average of nearly 8% of total expenditures in reserve coming into this crisis, but without additional federal support significant austerity measures will be needed. Reflecting the uncertain outlook, credit spreads widened over the last two months (10-Yr BBB spreads widened 181 bps since the end of February) as investors and the rating agencies assess the negative credit impact across various market sectors. Fortunately, many states across the country have already begun the gradual but essential process of reopening.

Negative Returns as the Yield Curve Steepened and Credit Spreads Widened

Only short-term maturities were able to achieve a positive return in April thanks to the decline in short rates. Both intermediate and long-term maturity segments fell into negative territory as long rates rose. The credit concerns mentioned above weighed heavily on lower quality issues last month as BBBs lagged the return of AAAs by 307 bps. YTD, the High Yield municipal category has fallen more than 10% thanks to heavy selling pressure and the possibility of rising defaults in this segment of the market.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	April	YTD	Bloomberg Barclays Quality	April	YTD
Municipal Bond Index	-1.26%	-1.88%	AAA	-0.38%	0.16%
General Obligation bonds	-0.94%	-0.83%	AA	-0.92%	-0.89%
Revenue bonds	-1.53%	-2.52%	A	-1.79%	-3.06%
Prerefunded bonds	0.41%	0.70%	BBB	-3.45%	-8.01%
Long maturities (22+ yrs.)	-2.64%	-3.80%	High Yield	-3.37%	-10.02%
Intermediate maturities (1 - 17 yrs.)	-0.71%	-1.21%	HY, ex-Puerto Rico	-3.58%	-10.19%
Short maturities (1 - 5 yrs.)	0.13%	-0.28%			

Disclosures

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.

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.