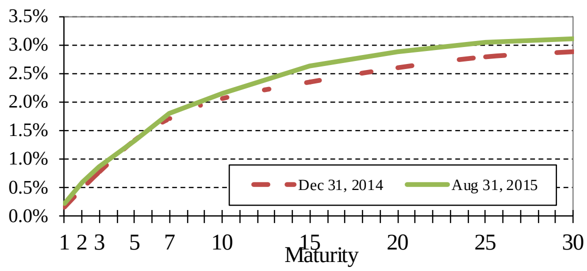
Baird Advisors
Municipal Fixed Income Market Comments
August 2015

Relative Calm Amid Global Volatility

The municipal market remained relatively calm in the midst of heightened global market volatility in August. The catalyst for the turmoil was a devaluation of the Chinese currency, which triggered significant price swings across financial and commodity markets. To illustrate the relative stability of municipals, the intra-month trading range for ten-year, tax-free yields was less than one-half that of similar maturity Treasuries (14 bps and 39 bps, respectively). The modest municipal yield changes occurred despite persistent, albeit modest, fund outflows across the industry and heavy new supply. August supply of over $30B was 24% higher than year-ago levels and year-to-date total tax-free issuance is up 40% YoY. Two factors helped mute municipal yield volatility. The first was strong reinvestment demand, as more than $15B in coupon and maturity payments rolled off last month. The second factor was the relative appeal of municipals versus Treasuries. As 10-year Treasury yields fell to 2.0% and below, high-quality tax-free yields remained above 2.0%, pushing the municipal/Treasury yield ratio over 100% in that segment of the curve. Relative to corporates, tax-free yields were less compelling due to the recent widening of corporate credit spreads.

AAA Municipal Yields



Maturity	Dec 31, 2014	Jun 30, 2015	Jul 31, 2015	Aug 31, 2015	1Mo Change	YTD Change
1	0.16%	0.31%	0.27%	0.23%	-0.04%	0.07%
2	0.48%	0.63%	0.62%	0.59%	-0.03%	0.11%
3	0.78%	0.93%	0.87%	0.86%	-0.01%	0.08%
5	1.33%	1.38%	1.30%	1.33%	0.03%	0.00%
7	1.71%	1.87%	1.82%	1.80%	-0.02%	0.09%
10	2.06%	2.28%	2.19%	2.16%	-0.03%	0.10%
30	2.88%	3.28%	3.12%	3.10%	-0.02%	0.22%

Credit News

- Puerto Rico's credit challenges continue, although investors increasingly view the island's fiscal troubles as isolated from the rest of the municipal market. A five year fiscal stability and economic development plan from a Governor-appointed working group, expected on August 31, was delayed, which also prevented a $750 million Aqueduct and Sewer Authority (PRASA) issue from being issued. Puerto Rican officials continue to lobby the U.S. Congress for bankruptcy authorization for certain island entities, but so far the prospects for approval seem remote.
- Merritt Research Services, which focuses on municipal credit research, reviewed the financial statements of nearly 1,200 municipalities as of fiscal year 2014. They found that the percentage of municipalities with a general fund deficit was at a six year low. In addition, the median general fund cash position for the same municipalities had improved to 106 days, up from the low point of 81 days in fiscal year 2010. They expect the favorable trend to continue.
- Moody's revised their outlook for the Healthcare sector to stable from negative, which is where it had been since the financial crisis in 2008. They found that the Affordable Care Act (ACA) had led to higher patient volumes and a greater percentage of insured patients, both positive trends which have improved margins for hospital providers.

Marginally Positive Returns in August

There was little difference in returns across the municipal market last month as all returns were marginally positive. Longer maturities (22+ years) slightly outperformed the short end of the curve (1 – 5 years) by 17 bps. In the investment grade space, higher quality issues outperformed lower quality debt by as much as 25 bps, but the high yield segment set the pace for the month as it has on a YTD basis – if Puerto Rico debt is excluded.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Barclays Index/Sector	Aug	YTD	Barclays Quality	Aug	YTD
Municipal Bond Index	0.20%	1.04%	AAA	0.24%	0.97%
General Obligation bonds	0.21%	0.85%	AA	0.25%	1.16%
Revenue bonds	0.19%	1.14%	A	0.10%	0.86%
Prerefunded bonds	0.15%	0.60%	BBB	0.00%	1.09%
Long maturities (22+ yrs.)	0.27%	1.30%	High Yield	0.41%	-2.05%
Intermediate maturities (1 - 17 yrs.)	0.19%	0.97%	HY - ex Puerto Rico	0.45%	3.18%
Short maturities (1 - 5 yrs.)	0.10%	0.81%			

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, prerefunded 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.