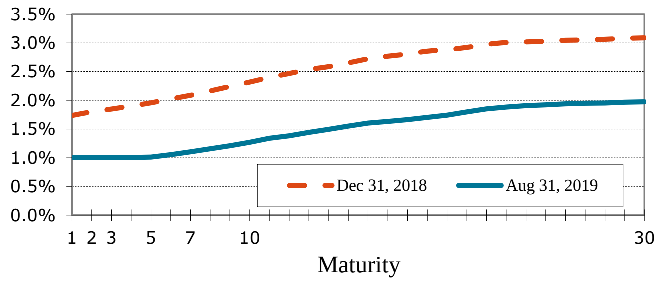
Baird Advisors
Municipal Fixed Income Market Commentary
August 2019

Tax-free Rally Continues, Relative Valuation to Treasuries Improves

Municipals experienced another strong month of returns in August as yields fell across the entire curve. Long-term yields fell the most, with 30Yr rates declining 38 bps, more than either intermediate (-27 bps) or short-term yields (-9 bps), leading to a flatter curve. The summer months lived up to their pre-season billing of anticipated strength with a favorable supply/demand backdrop providing support. Although new issuance improved in August, rising 13% year-over-year and pushing YTD supply 5% ahead of last year's pace, the net outstanding supply of municipal debt decreased once again in August due to the heavy volume of debt rolling off. Also, the streak of positive consecutive weekly flows into municipal funds/ETFs stretched to 34 in August, the last eight weeks with inflows of at least $1.5B, illustrating the steady demand for tax-free bonds even as interest rates have fallen. As impressive as the municipal rally was last month, Treasury yields fell even more, improving the cross-market relative value of tax-free municipals to Treasuries. For example, the municipal/Treasury yield ratio between a AAA rated 10Yr tax-free bond relative to a 10Yr taxable Treasury improved from 75% at the end of July to 81% in August. At this cross-market yield relationship, an investor subject to an effective federal income tax higher than 19% would benefit from tax-free bonds over taxable Treasuries. Valuations in intermediate and longer maturities also improved in August.

AAA Municipal Yields



Maturity	Dec 31, 2018	Jul 31, 2019	Aug 31, 2019	1Mo	YTD
1	1.74%	1.09%	1.00%	-0.09%	-0.74%
2	1.80%	1.11%	1.01%	-0.10%	-0.79%
3	1.85%	1.12%	1.01%	-0.11%	-0.84%
5	1.96%	1.17%	1.01%	-0.16%	-0.95%
7	2.09%	1.30%	1.10%	-0.20%	-0.99%
10	2.32%	1.54%	1.27%	-0.27%	-1.05%
30	3.09%	2.35%	1.97%	-0.38%	-1.12%

Credit Updates: Municipal Cyber Risk is on the Rise, University of Alaska Budget Cuts

The Texas Department of Information Resources reported that 23 municipalities in the state were the victim of ransomware in August. The cyber-attacks in Texas highlight the growing risk across the country, particularly for smaller municipalities with limited technology resources. The Texas municipalities paid an estimated $12.4 million collectively in ransom, not to mention the inconvenience of interrupted revenue collections and impact on basic city services. According to the New York Times, over forty municipalities have been cyber victims this year alone, with hospitals and electric utilities at the greatest risk.

Alaska's Governor, Mike Dunleavy, caught the attention of investors across the nation recently when he cut funding for the University of Alaska system by $140 million, or 40% of their budget. The Governor ran on a pledge to boost the oil-dividends each Alaska resident receives, and used his veto power to make the drastic budget cuts to achieve that. A cut of that magnitude in a single year would have devastated the university system. Fortunately, he and the legislature were able to reach a compromise and smaller cuts, totaling $70 million over a three year period, will now occur. Fiscal austerity remains evident in many states.

Strongest August Returns in Seven Years

The sharp declines in tax-free rates in August matched the strong returns of March earlier this year and were the best August returns since 2011. Longer maturities outperformed short-term issues as the curve flattened over the month. The Revenue sector marginally outperformed GOs, while Prere's lagged significantly. Lower quality issues outperformed higher rated categories as investors searched for excess yield where they could find it.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	August	YTD	Bloomberg Barclays Quality	August	YTD
Municipal Bond Index	1.58%	7.61%	AAA	1.43%	6.91%
General Obligation bonds	1.48%	7.31%	AA	1.48%	7.21%
Revenue bonds	1.70%	8.05%	A	1.69%	8.18%
Prerefunded bonds	0.33%	3.31%	BBB	2.09%	9.73%
Long maturities (22+ yrs.)	2.54%	10.51%	High Yield	2.41%	9.91%
Intermediate maturities (1 - 17 yrs.)	1.16%	6.45%	HY, ex-Puerto Rico	1.99%	9.10%
Short maturities (1 - 5 yrs.)	0.27%	3.30%			

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.