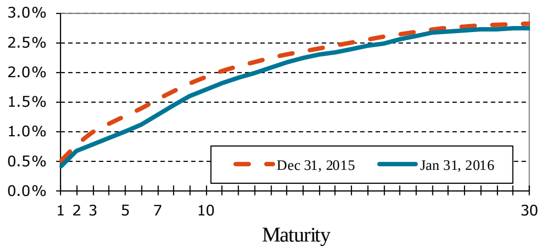
Baird Advisors
Municipal Fixed Income Market Comments
January 2016

Municipals – A Safe Haven from the Storm

While the municipal market provided a relative safe haven for investors in the midst of January's heightened volatility, tax-free yields were unable to keep pace with the sharp decline in Treasury yields. It was an impressive start to the new year, nonetheless, as tax-free yields fell across the curve. Similar to the Treasury market, the most significant yield change among tax-free yields occurred in the 5 – 7 year maturity range where yields fell 26 bps. New issuance of $24.1B was relatively robust for a January, above long-term averages for the month, but was still 18% below the very strong start last year. Demand also remained firm, helped by January's typically strong reinvestment needs, evident in the consistent inflows to tax-free funds throughout the month. One benefit of the more moderate decline in municipal yields last month was the realignment of relative valuations between the tax-free and taxable markets. After closing 2015 on the richer side of recent comparisons to taxable, municipal yields moved closer to long-term averages in January.

AAA Municipal Yields



Maturity	Jan 31, 2015	Oct 31, 2015	Dec 31, 2015	Jan 31, 2016	1Mo Change	3Mo Change	12Mo Change
1	0.14%	0.27%	0.50%	0.40%	-0.10%	0.13%	0.26%
2	0.41%	0.56%	0.77%	0.66%	-0.11%	0.10%	0.25%
3	0.61%	0.77%	0.99%	0.78%	-0.21%	0.01%	0.17%
5	0.94%	1.18%	1.26%	1.00%	-0.26%	-0.18%	0.06%
7	1.34%	1.60%	1.54%	1.28%	-0.26%	-0.32%	-0.06%
10	1.75%	2.05%	1.92%	1.71%	-0.21%	-0.34%	-0.04%
30	2.54%	3.06%	2.82%	2.75%	-0.07%	-0.31%	0.21%

Energy's Impact on the Municipal Market

While the impact of lower energy prices on municipal credits may not be as direct or obvious as it is on individual companies in the corporate or equity markets, not surprisingly there are both winners and losers in the municipal market as well. The biggest fiscal challenges from the recent energy price declines are felt most acutely in a handful of states. According to S&P, the states with the highest percentage of their fiscal 2014 budget from energy related tax revenues, in declining order, were: Alaska, Wyoming, New Mexico, Louisiana, Texas, North Dakota, and Oklahoma. Among these, Alaska stands out with nearly 90% of total state revenues coming from oil and mineral-related taxes, nearly three times that of the distant second, Wyoming, at 31%. Helping to offset Alaska's high energy dependency, however, are also high reserve levels. The state has nearly $10B in budget reserve funds and over $51B in a Permanent Fund, created in 1976 to capture a portion of energy tax revenue. All of the energy dependent states are now responding to lower energy-related revenues and are working to address projected budget gaps. Governor Walker of Alaska, for example, has proposed implementing an income tax where none existed before to help close a projected $3.5B budget gap. The "lower for longer" view on energy prices will require tough decisions.

The good news, however, is that although some municipalities will struggle with lower energy-related tax revenues, for the vast majority of municipalities lower energy costs are a benefit to their budget. Lower energy prices are a windfall for most state and local governments, as it is for consumers, as less is spent on the heating/cooling of facilities and on fuel for vehicles. The Transportation sector, in particular, benefits as more miles are travelled both in the air and on the road. Not surprisingly, toll road revenues are on the rise as are the revenues at most major airports. Finally, more discretionary income for consumers should, over time, strengthen the debt coverage on sales tax revenue backed securities.

A Strong Start to the New Year

The most conservative components of the municipal market, short maturities and Prerefunded bonds, lagged the rest of the market last month. The remaining maturity segments, market sectors, and quality ratings all produced a monthly return of approximately 1.2%. Puerto Rico uncertainty muted performance in the High Yield sector, but ex-Puerto Rico the High Yield municipal market returned over 1.0%, diverging sharply from the negative returns in the corporate high yield sector.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Barclays Index/Sector	Jan	3Mo	YTD	Barclays Quality	Jan	3Mo	YTD
Municipal Bond Index	1.19%	2.31%	1.19%	AAA	1.17%	1.95%	1.17%
General Obligation bonds	1.20%	2.24%	1.20%	AA	1.17%	2.14%	1.17%
Revenue bonds	1.26%	2.54%	1.26%	A	1.25%	2.75%	1.25%
Prerefunded bonds	0.56%	0.41%	0.56%	BBB	1.20%	2.69%	1.20%
Long maturities (22+ yrs.)	1.16%	3.17%	1.16%	High Yield	0.57%	1.12%	0.57%
Intermediate maturities (1 - 17 yrs.)	1.19%	1.93%	1.19%	HY, ex-Puerto Rico	1.06%	2.46%	1.06%
Short maturities (1 - 5 yrs.)	0.62%	0.43%	0.62%				

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.