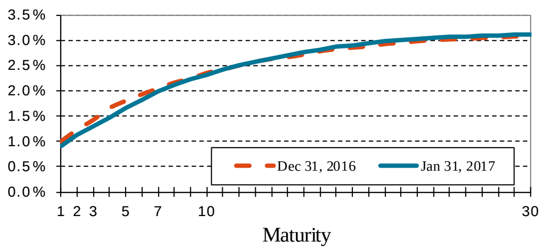
Baird Advisors
Municipal Fixed Income Market Comments
January 2017

A Flurry with Little Clarity

President Trump hit the ground running once inaugurated with a series of cabinet appointments, executive actions and a nomination to the Supreme Court. Despite the flurry of activity, investors still lack clarity and specifics on several of his key policy initiatives, including: healthcare reform, tax reform, and infrastructure spending, all of which will have both revenue and spending implications for state and local governments. The uncertainties municipalities face come as tax revenue growth is slowing and economic growth has been disappointing. The Q3 2016 state and local tax revenues were up 2.2% YoY, according to recent U.S. Census Bureau data. U.S. economic growth in Q4 was 1.9%, only marginally better than the 1.6% pace of economic growth for all of 2016. Yet, optimism in the post-election environment is high, as measures of consumer and business sentiment have improved sharply. It's too soon to know how this will translate into economic growth and tax revenue, but a faster pace of each would be welcomed by investors and municipalities alike. January started with a positive tone in the municipal market as yields fell slightly across most of the curve, helped in part by modest tax-free fund inflows once the year-end tax-loss selling ceased. The curve steepened somewhat as short-term rates fell more than intermediate yields while rates on the longest maturities rose slightly. New supply surprised to the upside as January issuance rose 23% from the previous year.

AAA Municipal Yields



Maturity	Jan 31, 2016	Oct 31, 2016	Dec 31, 2016	Jan 31, 2017	1Mo Change	3Mo Change	12Mo Change
1	0.40%	0.70%	1.00%	0.91%	-0.09%	0.21%	0.51%
2	0.66%	0.84%	1.23%	1.12%	-0.11%	0.28%	0.46%
3	0.78%	0.94%	1.43%	1.30%	-0.13%	0.36%	0.52%
5	1.00%	1.13%	1.80%	1.67%	-0.13%	0.54%	0.67%
7	1.28%	1.36%	2.05%	1.99%	-0.06%	0.63%	0.71%
10	1.71%	1.73%	2.35%	2.31%	-0.04%	0.58%	0.60%
30	2.75%	2.56%	3.08%	3.11%	0.03%	0.55%	0.36%

U.S. Infrastructure Agreement/Disagreement

Republicans and Democrats broadly agree on the need for more infrastructure spending and investment. It was one of President Trump's major campaign themes and, although not widely reported, the Trump transition team reached out to the National Governors Association (NGA) asking for a list of major infrastructure project ideas. The NGA responded with a list of 50 that reportedly are already being vetted by the Trump administration. In addition, last year the U.S. Treasury Department commissioned a study seeking a list of the top 40 transportation and water infrastructure projects, which the report found would produce up to $1.1 trillion of economic benefits at a total capital cost of "just" $334 billion. Not to be left out, senior Democratic Senators last month put forth a $1 trillion infrastructure spending plan of their own which they estimate would produce 15 million jobs over ten years. Clearly, there is no shortage of projects to be done, nor general agreement on the beneficial impact on productivity and economic growth that an infrastructure focus would have. Unfortunately, the two sides have dramatically different approaches as to how to pay for their plans. Democrats favor more direct federal spending while Republicans, hesitant to add to the deficit, are instead focused on federal tax credits and public-private partnerships (P3's). To incentivize sufficient private capital, however, the P3 projects typically need a revenue stream in order to provide an acceptable rate of return. Several revenue ideas have been proposed including removing restrictions against the tolling of interstate highways, in essence creating a new user fee that could be leveraged. Not surprisingly, this idea causes its own complications and objections. Very quickly one begins to see the challenges of reaching agreement on something, ironically, on which nearly everyone agrees!

Solid Start to 2017

Returns were positive in January with relatively little variability across the yield curve. The steepening of the curve led to marginally better returns among short and intermediate maturities rather than longer debt. There was also little differentiation across market sector performance. Lower quality, investment grade issues marginally outperformed higher quality securities last month, with High Yield municipals far outpacing all other issues.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	January	3Mo	1 Yr	Bloomberg Barclays Quality	January	3Mo	1 Yr
Municipal Bond Index	0.66%	-1.96%	-0.28%	AAA	0.58%	-1.87%	-0.75%
General Obligation bonds	0.65%	-2.07%	-0.77%	AA	0.65%	-1.83%	-0.46%
Revenue bonds	0.68%	-2.11%	-0.14%	A	0.70%	-2.14%	0.30%
Prerefunded bonds	0.57%	-0.34%	0.00%	BBB	0.74%	-2.50%	-0.11%
Long maturities (22+ yrs.)	0.61%	-2.86%	0.33%	High Yield	1.40%	-3.31%	3.85%
Intermediate maturities (1 - 17 yrs.)	0.70%	-1.59%	-0.47%	HY, ex-Puerto Rico	1.31%	-3.59%	1.96%
Short maturities (1 - 5 yrs.)	0.67%	-0.30%	0.12%				

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.

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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.