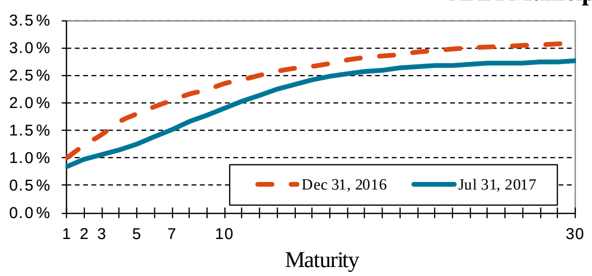
Baird Advisors
Municipal Fixed Income Market Comments
July 2017

Lower Yields and Flatter Municipal Curve in July

The municipal market provided investors another solid month of returns in July as tax-free yields fell modestly and credit spreads narrowed. There was solid demand across the curve, particularly in the 5-year maturity range, where tax-free yields fell 13 bps, twice the decline of comparable maturity Treasuries. Light new supply continued to offer technical support for the market with July's volume 20% below a year ago and YTD issuance off 13% from the 2016 pace. Demand for municipals remained steady in part due to the ongoing political stalemate in Washington. The Senate failed in its efforts to repeal the Affordable Care Act highlighting the challenges ahead for tax reform. A group of Congressional leaders and senior White House officials (aka the "Big Six") working behind the scenes released a few key elements of a plan framework, but was short on details. They admitted that the controversial border adjustment tax (BAT) idea was dead, eliminating an estimated $1 trillion of potential new tax revenue. Also, the budget resolution passed by the House Budget Committee only allows for revenue neutral tax reform, which implies less meaningful changes to the tax code than many believed following last November's election.

AAA Municipal Yields



Maturity	Dec 31, 2016	Apr 30, 2017	Jul 31, 2017	1Mo Change	3Mo Change	YTD Change
1	1.00%	0.84%	0.85%	0.01%	0.01%	-0.15%
2	1.23%	1.01%	0.98%	-0.01%	-0.03%	-0.25%
3	1.43%	1.18%	1.06%	-0.05%	-0.12%	-0.37%
5	1.80%	1.45%	1.23%	-0.13%	-0.22%	-0.57%
7	2.05%	1.78%	1.51%	-0.09%	-0.27%	-0.54%
10	2.35%	2.16%	1.90%	-0.06%	-0.26%	-0.45%
30	3.08%	3.02%	2.76%	-0.05%	-0.26%	-0.32%

Three Credit Updates

First, the drama in Illinois over the budget deadline stretched into early July but was ultimately resolved when the legislature passed a budget, over Gov. Rauner's veto. Both personal and corporate income tax rates were raised and spending cuts were enacted for state agencies and universities. The state's credit rating was affirmed as investment grade by the major rating agencies. Investors reacted positively by making Illinois the best performing state GO for the month. There remains an ongoing battle between the governor and legislature over funding for the Chicago Public School system, the debate over which could impact funding for other school districts also, just as the new school year is set to begin. Second, the rating for National Public Finance Guaranty (NPFG), the municipal bond insurance unit of MBIA, was lowered last month by S&P to A from AA-. S&P cited the "very low volume" of debt that NPFG had insured in recent years and questioned its long-term viability. NPFG's two main insurance competitors, Assured Guaranty (AGM) and Build America Mutual (BAM) each still carry AA ratings by S&P, making it very difficult for NPFG to compete. NPFG will now essentially go into run-off mode, no longer looking to underwrite new business. They appear to have sufficient reserves to honor municipal obligations guaranteed, pending the resolution on outstanding Puerto Rico debt obligations. Finally, construction on two nuclear reactors in South Carolina was halted due to significant cost overruns and delays, as well as the bankruptcy filing of the reactor builder, Westinghouse. Santee Cooper, the state-owned electric utility which has a 45% stake in the reactors (South Carolina Electric & Gas owns 55%), had already raised rates five times since 2009 to help pay for the project and feared excessive increases going forward. Outstanding South Carolina Public Service debt for Santee Cooper will continue to be paid by the electric customers.

Best July Performance Since 2012

Lower tax-free yields and a modest narrowing of credit spreads led to the best July performance for the municipal market since 2012. General Obligation issues outperformed other sectors of the market and longer maturities outpaced returns across shorter segments of the yield curve. Moderate credit risk was rewarded as BBB rated issues outperformed both higher quality and lower quality (below investment grade) municipal debt last month.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	July	3Mo	YTD	Bloomberg Barclays Quality	July	3Mo	YTD
Municipal Bond Index	0.81%	2.04%	4.40%	AAA	0.73%	1.77%	3.94%
General Obligation bonds	0.94%	2.06%	4.43%	AA	0.78%	1.95%	4.21%
Revenue bonds	0.80%	2.20%	4.69%	A	0.79%	2.19%	4.76%
Prerefunded bonds	0.37%	0.61%	1.91%	BBB	1.29%	2.76%	5.66%
Long maturities (22+ yrs.)	0.97%	2.99%	5.56%	High Yield	0.66%	1.97%	6.83%
Intermediate maturities (1 - 17 yrs.)	0.73%	1.66%	3.97%	HY, ex-Puerto Rico	0.92%	3.00%	9.19%
Short maturities (1 - 5 yrs.)	0.43%	0.67%	2.21%				

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.