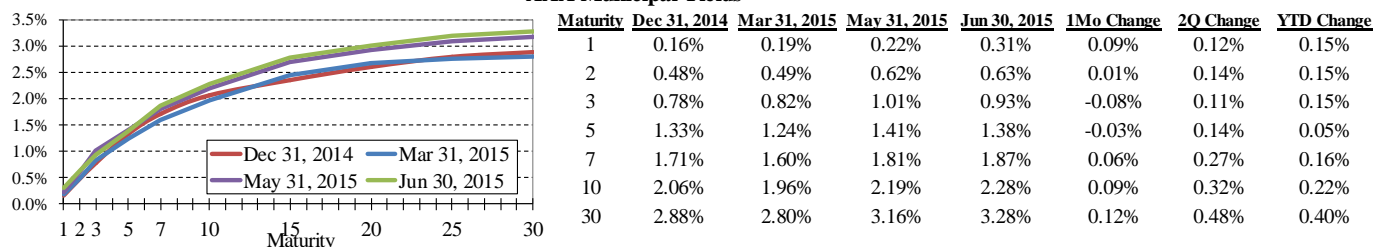


Baird Advisors
Municipal Fixed Income Market Comments
June 2015

Higher Rates and Steeper Curve in Q2

Global bond yields rose last quarter, putting upward pressure on U.S. rates at the same time that domestic economic activity improved modestly. The pace of hiring accelerated in the May/June period, averaging nearly 240,000 per month, compared to a 150,000 average monthly pace in the prior two months. Municipal yields also moved higher and the curve steepened as long-term rates rose more than short-term; similar in direction as moves in the Treasury market, but not necessarily magnitude. For the quarter, the technical position of the municipal market was mixed. While the amount of debt rolling off from calls and maturities exceeded new issuance, municipal funds experienced modest outflows during the last eight weeks of the quarter. New issue supply was abundant, however, with year-to-date issuance running more than 40% above last year’s pace through June. Two-thirds of the new supply was refunding-related as municipalities capitalize on the opportunity to refinance outstanding debt issued when rates were higher.

AAA Municipal Yields



Credit News

While the international markets were focused on Greece, the municipal world was preoccupied with Puerto Rico. The Governor of Puerto Rico recently stated that its “public debt...is unpayable,” pushing prices on all of the island debt lower. While all of the July 1st debt payments were made as scheduled on Puerto Rico credits, a restructuring of at least some of the \$72B of debt seems increasingly likely. Unless granted the authority by Congress, Chapter 9 bankruptcy, which is available exclusively for municipalities, is not an option. So how the restructuring process might work is just one of the many uncertainties surrounding Puerto Rico.

In other credit news, the U.S. Supreme Court upheld the lower court ruling in the *King vs. Burwell* case, which will allow the premium subsidies to continue in states with a federally run health exchange. The ruling provided support both for the Affordable Care Act as well as the hospital sector of the municipal market. Hospital revenues and operating margins have improved as more of the patients they serve have insurance coverage.

Minimal Returns YTD

The steepening of the yield curve weighed on the monthly and quarterly returns of the long end of the market as maturities beyond 22 years underperformed other curve segments. Similar to the widening of credit spreads in the taxable corporate market, lower quality issues also lagged higher quality issues for the month and quarter. Consistent with this, the Prerefunded sector easily outperformed both GOs and Revenue bonds for the quarter. The high yield tax-free market has been materially affected by the performance of Puerto Rico credits, which represented 26% of the Municipal High Yield Index at the end of June. Ex-Puerto Rico, the High Yield Index would have been the best performing segment of the market for the quarter and YTD.

Total Returns of Selected Barclays Municipal Indices and Subsectors

<u>Barclays Index/Sector</u>	<u>June</u>	<u>2nd Qtr</u>	<u>YTD</u>	<u>Barclays Quality</u>	<u>June</u>	<u>2nd Qtr</u>	<u>YTD</u>
Municipal Bond Index	-0.09%	-0.89%	0.11%	AAA	-0.05%	-0.74%	0.05%
General Obligation bonds	-0.08%	-0.93%	-0.07%	AA	-0.07%	-0.82%	0.15%
Revenue bonds	-0.12%	-0.94%	0.17%	A	-0.09%	-1.04%	0.00%
Prerefunded bonds	0.12%	-0.18%	0.14%	BBB	-0.38%	-1.04%	0.70%
Long maturities (22+ yrs.)	-0.32%	-1.59%	-0.04%	High Yield	-3.69%	-3.00%	-1.92%
Intermediate maturities (1 - 17 yrs.)	-0.01%	-0.66%	0.17%	HY - ex Puerto Rico	-0.63%	-0.62%	1.88%
Short maturities (1 - 5 yrs.)	0.19%	-0.02%	0.39%				

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.