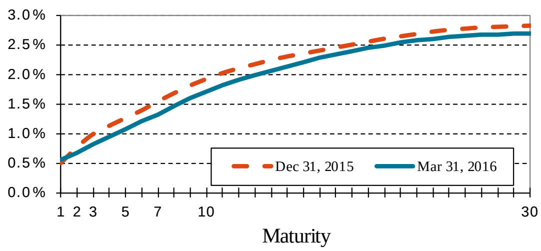
Baird Advisors
Municipal Fixed Income Market Comments
March 2016

Municipal Stability in a Volatile Quarter

The first quarter of 2016 provided municipal investors what they often desire most from their allocation – stability. Amid the heightened volatility in other asset classes, including sectors of the taxable fixed market, tax-free rates were relatively calm. Demand for municipal debt was strong, evident in the consistently positive flows into tax-free funds. According to Lipper, municipal fund flows have been positive for 26 consecutive weeks, stretching back well into 2015. On the other side, supply was robust but insufficient for the demand. New issues were typically oversubscribed, often trading at higher prices post-issuance in the secondary market. Total first quarter supply was off 12% from last year's pace, primarily due to less refunding activity relative to early-2015. This favorable supply/demand backdrop helped market yields drift lower across most of the tax-free yield curve. Municipal yields, however, fell less than one-half the decline in Treasury rates, which responded very favorably to a more dovish U.S. (and global) monetary policy outlook. There was modest upward pressure on the shortest tax-free rates while intermediate yields fell, leading to a flatter curve. For the quarter, the yield spread between the 1-year and 10-year maturities narrowed by an impressive 27 bps. The market inflows and flattening curve demonstrated willingness by investors to participate in the municipal sector and to extend the average maturity of their purchases.

AAA Municipal Yields



Maturity	Mar 31, 2015	Dec 31, 2015	Feb 29, 2016	Mar 31, 2016	1Mo Change	1Q Change	12Mo Change
1	0.17%	0.50%	0.39%	0.55%	0.16%	0.05%	0.38%
2	0.47%	0.77%	0.54%	0.67%	0.13%	-0.10%	0.20%
3	0.80%	0.99%	0.68%	0.81%	0.13%	-0.18%	0.01%
5	1.23%	1.26%	0.93%	1.07%	0.14%	-0.19%	-0.16%
7	1.58%	1.54%	1.30%	1.32%	0.02%	-0.22%	-0.26%
10	1.95%	1.92%	1.76%	1.70%	-0.06%	-0.22%	-0.25%
30	2.80%	2.82%	2.80%	2.82%	0.02%	0.00%	0.02%

Credit Updates

Illinois is now the only state operating without a 2016 budget after Pennsylvania ended its nine-month stalemate in March. Pennsylvania's Democratic governor allowed the budget that passed through the Republican legislature to become law without his signature. Hope for a similar near-term resolution in Illinois, however, seems remote, as neither the Republican governor nor Democratic controlled state legislature appear open to compromise. In related news, the Illinois Supreme Court ruled Chicago's 2014 pension reform law as unconstitutional. While not unexpected, the city is now forced to consider alternative plans to address its long-term pension funding gap. While there was little market reaction, and both Moody's and S&P said they would await the city's next steps before reviewing their ratings, Fitch elected to downgrade Chicago's debt rating two notches to BBB-. Uncertainty over Puerto Rico's debt restructuring continues as the target date of March 31 that House Speaker Paul Ryan had set for a comprehensive plan was not met. Senator Menendez (D-NJ) sponsored a bill that would provide broad restructuring authority to Puerto Rican officials. The bill subordinates all debt, including general obligation debt, to pension liabilities. This is unlikely to pass a Republican controlled Congress that seems less willing to allow massive debt relief without first establishing a strong financial control board that would oversee all of the island's fiscal related matters. The clock is ticking as the next significant debt payments in Puerto Rico are due on May 1st.

Strong Quarterly Returns

Allocation along the yield curve was important, both in March and for the quarter. Short maturity benchmarks lagged intermediate and longer indices as strong demand helped to flatten the yield curve. Lower quality, investment grade municipal debt (BBB) outperformed all other rating categories. High yield issues, even when Puerto Rico is excluded, lagged in March and provided only modest outperformance relative to higher quality debt for the quarter. Puerto Rico performance has been volatile, not surprisingly given the ongoing credit uncertainty and the significant hedge fund influence on trading activity.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Barclays Index/Sector	Mar	3Mo	12Mo	Barclays Quality	Mar	3Mo	12Mo
Municipal Bond Index	0.32%	1.67%	3.98%	AAA	0.21%	1.51%	3.46%
General Obligation bonds	0.20%	1.51%	3.75%	AA	0.23%	1.56%	3.76%
Revenue bonds	0.41%	1.84%	4.35%	A	0.48%	1.92%	4.60%
Prerefunded bonds	-0.18%	0.63%	1.31%	BBB	0.60%	2.03%	4.52%
Long maturities (22+ yrs.)	0.88%	2.24%	5.19%	High Yield	-0.02%	1.66%	2.35%
Intermediate maturities (1 - 17 yrs.)	0.09%	1.46%	3.46%	HY, ex-Puerto Rico	0.08%	1.76%	6.72%
Short maturities (1 - 5 yrs.)	-0.24%	0.71%	1.51%				

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.