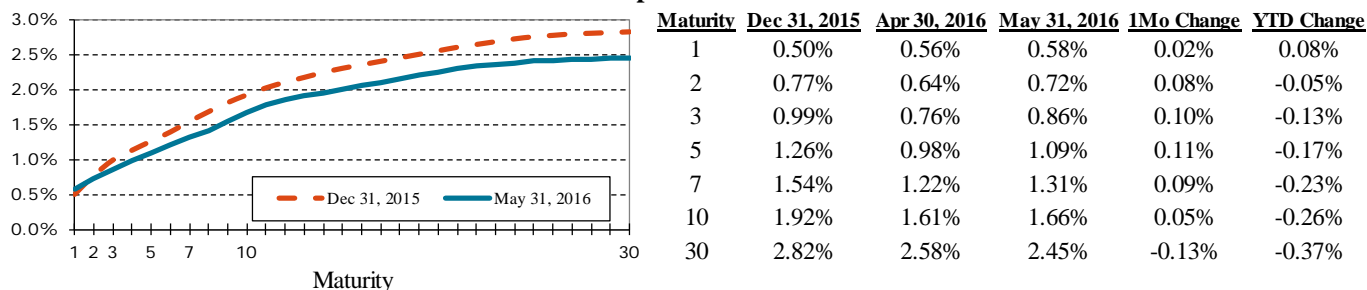


**Baird Advisors**  
**Municipal Fixed Income Market Comments**  
**May 2016**

**The Fed and Strong Demand Flatten the Yield Curve**

A more hawkish message from several Fed governors as well as the Chairwoman herself, Janet Yellen, made clear the Fed's desire to raise rates "in the coming months" if the data and markets allow. Short and intermediate term municipal yields rose modestly on the evolving Fed rate outlook, while the long end of the curve took a different path. Long yields fell on strong and broad-based investor demand, most evident in the consistent inflows to municipal funds which have been positive for 34 consecutive weeks. In addition to the tailwind provided by individuals seeking tax-free income, there has also been steady institutional buying from banks, insurance companies, and even foreign investors who receive no tax benefit but are attracted to the higher credit quality and favorable yields relative to other options around the globe. Not surprisingly, the market reacted favorably to a modest uptick in May supply, up 8% from the prior month, but still 7% off last year's pace. The largest tax-free deal last month, a \$2.3B issue to finance a much-needed new Terminal B at LaGuardia airport, illustrates the broad investor demand for municipals. The underwriter reported over \$20B in orders from nearly 150 institutional investors for the deal.

**AAA Municipal Yields**



**Credit Updates**

Transportation-related credits, such as the LaGuardia airport issue, are benefiting from an expanding economy and lower energy prices. Enplanements (the number of passengers boarding a plane) at LaGuardia in 2015 rose 5.5% from the prior year and have grown an average of 3.5% annually over the last five years. More broadly, enplanements nationally grew nearly 7% in 2015 according to the Bureau of Transportation Statistics, the fastest pace since 2005. Toll roads are also seeing more traffic and higher revenue. Across the 45 toll roads that Moody's rates, traffic volume is expected to grow a median of 3% this year with revenues up 5%-6% on anticipated fare hikes.

A U.S. House committee recently passed a bill (H.R. 5278) that would create a federal oversight board to address Puerto Rico's debt crisis. The bill will soon be considered by the full House, but is unlikely to be in place prior to the \$2B in July 1 debt payments, \$800 million of which is for general obligation debt. The bill provides broad powers to a seven member board, the members of which are nominated by Congress and appointed by the President, to oversee the island's finances and debt restructuring. The bill provides the necessary structural framework to work through the complex challenges Puerto Rico faces.

It is now very likely that Illinois will go the full fiscal year without a budget. The Spring legislative session has ended and passage now requires a three-fifths majority. The fiscal year ends June 30th so the governor and legislative leaders are now focused on a stopgap plan to fund the government through at least December to get beyond the November election.

**Modestly Positive Month**

Returns were positive in May across most of the municipal market, the exceptions being the shortest maturities (1-5 years) and safest sector (Pre-refunded). Risk-seeking investors were generally rewarded with better returns as longer duration benchmarks and lower quality issues outperformed more conservative positions. Puerto Rico continued to be a modest drag on performance, but even including Puerto Rico, the high yield sector was by far the best performing segment of the municipal market last month.

**Total Returns of Selected Barclays Municipal Indices and Subsectors**

<u>Barclays Index/Sector</u>	<u>May</u>	<u>3Mo</u>	<u>12Mo</u>	<u>Barclays Quality</u>	<u>May</u>	<u>3Mo</u>	<u>12Mo</u>
Municipal Bond Index	0.27%	1.33%	5.87%	AAA	0.11%	0.97%	4.96%
General Obligation bonds	0.17%	1.08%	5.56%	AA	0.20%	1.13%	5.47%
Revenue bonds	0.35%	1.57%	6.43%	A	0.43%	1.78%	6.97%
Prerefunded bonds	-0.03%	-0.03%	1.77%	BBB	0.56%	1.97%	6.65%
Long maturities (22+ yrs.)	0.87%	2.82%	8.60%	High Yield	1.32%	1.40%	3.07%
Intermediate maturities (1 - 17 yrs.)	0.05%	0.74%	4.81%	HY, ex-Puerto Rico	1.15%	1.35%	8.06%
Short maturities (1 - 5 yrs.)	-0.07%	-0.06%	1.91%				

## 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](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.