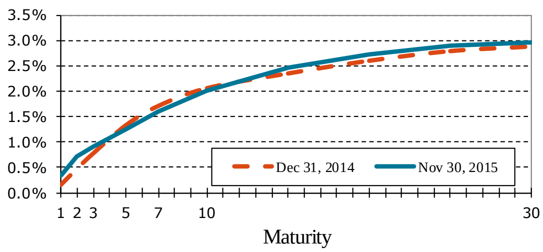
Baird Advisors
Municipal Fixed Income Market Comments
November 2015

Flatter Curve on Fed Rate Hike Expectations

Expectations for a rate hike at the December FOMC meeting rose sharply last month, which led to a significant reshaping of the municipal yield curve. Short-term rates rose as much as 18 bps in anticipation of the Fed move while intermediate and long-term yields fell on moderate supply and strong demand. Continuing on the theme of lighter supply this quarter, November's issuance fell 22% month-over-month to just $23.2B, the lightest supply for a November in 15 years. However, new issuance is expected to rebound in December to approximately $30B, which would push total supply for the year just above $400B, the most since the $433B issued in 2010 during the Build America Bond (BAB) program. Even with the rate hike expectations, investor demand for tax-free debt was strong, particularly evident in the level of oversubscription on most of the new issues last month. Mutual fund flows were further evidence of investor demand as tax-free funds have received more new money this quarter than all of the outflows that occurred earlier in the year. Not surprisingly, with a moderate pace of new supply and solid demand tax-free yields richened relative to taxable alternatives, particularly among shorter maturities. The most attractive relative valuations at month end were found among intermediate and longer-term maturities, suggesting that a moderate barbell structure around the relatively rich three to five year maturity segment remains an appealing yield curve strategy.

AAA Municipal Yields



Maturity	Dec 31, 2014	Aug 31, 2015	Oct 31, 2015	Nov 30, 2015	1Mo Change	3Mo Change	YTD Change
1	0.16%	0.23%	0.23%	0.34%	0.11%	0.11%	0.18%
2	0.48%	0.59%	0.54%	0.72%	0.18%	0.13%	0.24%
3	0.78%	0.86%	0.76%	0.92%	0.16%	0.06%	0.14%
5	1.33%	1.33%	1.17%	1.26%	0.09%	-0.07%	-0.07%
7	1.71%	1.80%	1.58%	1.60%	0.02%	-0.20%	-0.11%
10	2.06%	2.16%	2.04%	2.02%	-0.02%	-0.14%	-0.04%
30	2.88%	3.10%	3.07%	2.96%	-0.11%	-0.14%	0.08%

Other Municipal News

- Voters approved 79% of the $23.8B in local municipal debt up for referendum in early-November. This was the highest approval rate for an odd-year election since 2007 and is a hopeful sign that tax payers may be warming to the idea of additional issuance to help meet the massive infrastructure needs in the U.S. Texas was by far the largest beneficiary, approving $10.3B of issuance, with $6.3B targeted for schools, including $1.6B for the Dallas School District alone.
- Puerto Rico made the scheduled $354 million of debt service payments on December 1st but to do so they elected to use their Constitutional "claw back" authority, which allows the Governor to redirect enterprise revenues to pay debt issued or guaranteed by the Commonwealth. There appears to be little Congressional support for assistance at this point.
- Third-party insurance on new municipal debt has rebounded modestly from post-crisis lows. Roughly 6% of primary market issuance has been insured in 2015, up from less than 4% in 2012-13. The still relatively low penetration rate offers greater yield disparity among municipal credits from which investors can choose.

Curve and Credit Drove "Risk-On" Outperformance

Last month, the municipal market rewarded investors who accepted a higher degree of risk. Positioning along the yield curve had a meaningful impact on returns as well. Short-term rates rose enough to push the returns on the shortest maturities into negative territory, while falling intermediate and longer rates provided positive performance for the rest of the yield curve. The negative performance in the Prerefunded sector was due primarily due to its predominant allocation among shorter maturities; the duration of the Prerefunded sector of the Barclays Municipal Bond Index is just 2.61 years. That said, lower quality credits did outperform higher quality issues on a duration neutral basis in November. The A and BBB quality categories outperformed AAA debt by +34 bps and +44 bps, respectively. Puerto Rico performance remained positive last month despite the uncertainty regarding their December 1st debt payments and high yield, ex-Puerto Rico, is the clear YTD winner.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Barclays Index/Sector	Nov	3Mo	YTD	Barclays Quality	Nov	3Mo	YTD
Municipal Bond Index	0.40%	1.53%	2.58%	AAA	0.25%	1.22%	2.21%
General Obligation bonds	0.36%	1.54%	2.40%	AA	0.31%	1.33%	2.50%
Revenue bonds	0.47%	1.64%	2.80%	A	0.59%	1.92%	2.79%
Prerefunded bonds	-0.13%	0.41%	1.01%	BBB	0.69%	2.33%	3.45%
Long maturities (22+ yrs.)	0.88%	2.06%	3.38%	High Yield	0.40%	3.78%	1.65%
Intermediate maturities (1 - 17 yrs.)	0.21%	1.31%	2.29%	HY, ex-Puerto Rico	0.56%	3.34%	6.63%
Short maturities (1 - 5 yrs.)	-0.15%	0.55%	1.43%				

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.