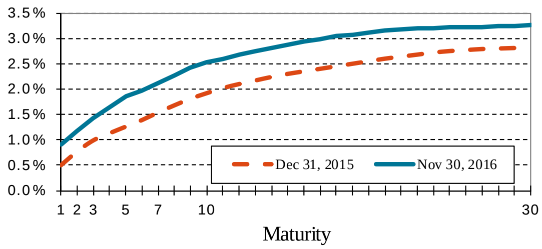
Baird Advisors
Municipal Fixed Income Market Comments
November 2016

Election Surprise Spurs Sharp Municipal Yield Adjustment

Not since September 2008, in the midst of the financial crisis, has the municipal market experienced the sharp price declines and volatility that occurred in November following the surprising election results. While expectations for faster economic growth and higher inflation caused a spike in Treasury yields, the combination of tax reform concerns and investor selling led to an even greater rise in tax-free yields. Over $7B of municipal fund redemptions occurred in the period between the election and month end. While tax-free yields rose across all maturities, the curve steepened as yields on five-year and longer maturities rose more than the shorter dated issues. The heightened volatility and underperformance of the municipal market relative to Treasuries was most evident among 10-year maturities, where Treasuries rose 54 bps and AAA-rated 10-year municipal yields rose 79 bps. This left tax-free yields at 106% of the taxable Treasury yield (2.52%/2.37%) – an unusual situation that seems to already reflect the potential for tax reform. Not surprisingly, the rise in municipal yields slowed the pace of new issuance, which fell 9% relative to November 2015. Year-to-date, however, total municipal supply is 10% ahead of last year's pace and is expected to exceed the record issuance of $433B in 2010. Looking to 2017, municipal supply is now expected to decline as much as 20% from 2016 levels. Higher rates should decrease the refunding supply and new money borrowing, even if a pick-up in infrastructure spending occurs, is not expected to sufficiently offset this decline. The quick, sharp and optimistic shift in market psychology following the election has occurred with few details from President-elect Trump. An infrastructure spending plan remains among the many unknowns, including the form it may take, how it will be financed, and at what pace.

AAA Municipal Yields



Maturity	Dec 31, 2015	Aug 31, 2016	Oct 31, 2016	Nov 30, 2016	1Mo Change	3Mo Change	YTD Change
1	0.50%	0.52%	0.70%	0.91%	0.21%	0.39%	0.41%
2	0.77%	0.61%	0.84%	1.16%	0.32%	0.55%	0.39%
3	0.99%	0.68%	0.94%	1.43%	0.49%	0.75%	0.44%
5	1.26%	0.86%	1.13%	1.85%	0.72%	0.99%	0.59%
7	1.54%	1.15%	1.36%	2.12%	0.76%	0.97%	0.58%
10	1.92%	1.42%	1.73%	2.52%	0.79%	1.10%	0.60%
30	2.82%	2.12%	2.56%	3.26%	0.70%	1.14%	0.44%

Noteworthy Election Results

Beyond retaking the White House and maintaining control of the House and Senate, the November elections also produced Republican gains at the state and local level. Three governorships switched from Democrat to Republican, bringing the GOP control to 33 out of 50 states, the most since 1922. The Republican influence also grew among state legislatures, where, according to the National Conference of State Legislatures, Republicans flipped three state legislative chambers and now control 66 out of 98 partisan state legislatures. While giving Republicans more power at the local, state, and federal levels of government, it does not appear the electorate was voting for fiscal austerity. Out of $70B in municipal spending initiatives on the November ballots across the country, the highest amount in ten years, voters approved 86%, authorizing nearly $60B worth of projects. California was the largest beneficiary, as 90% of separate school district referendums passed, providing $23B in borrowing for schools and community colleges. Texas voters approved 84% of school district measures as well, totaling $2.8B of bond authorization. Transportation spending was also favorably received by voters, with over $200B of spending initiatives for consideration, $175B worth were approved, although the vast majority of this amount is concentrated in just three metro areas: Atlanta, Los Angeles, and Seattle.

Sharply Negative Monthly Returns

The surprise election results led to sufficiently negative monthly returns to push year-to-date returns (ex- High Yield) into negative territory as well. Curve steepening caused long maturities to underperform intermediate and short indices by 173 bps and 370 bps, respectively. Heavy redemptions from high yield municipal funds widened credit spreads, causing the High Yield sector to be the worst performing municipal sector. Even Prerefunded issues, the best performing sector, produced negative returns as funds sold some of their most liquid positions to help meet shareholder redemptions.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	November	3Mo	YTD
Municipal Bond Index	-3.73%	-5.21%	-0.92%
General Obligation bonds	-3.77%	-5.20%	-1.33%
Revenue bonds	-4.03%	-5.66%	-0.87%
Prerefunded bonds	-1.16%	-1.58%	-0.27%
Long maturities (22+ yrs.)	-4.95%	-7.24%	-0.69%
Intermediate maturities (1 - 17 yrs.)	-3.22%	-4.36%	-0.95%
Short maturities (1 - 5 yrs.)	-1.25%	-1.72%	-0.22%

Bloomberg Barclays Quality	November	3Mo	YTD
AAA	-3.55%	-4.91%	-1.31%
AA	-3.59%	-5.03%	-1.10%
A	-3.98%	-5.57%	-0.36%
BBB	-4.32%	-6.00%	-0.80%
High Yield	-5.95%	-6.87%	1.59%
HY, ex-Puerto Rico	-6.34%	-7.79%	0.10%

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.