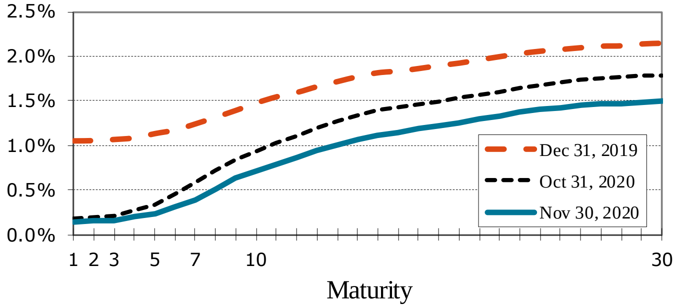
Baird Advisors
Municipal Fixed Income Market Commentary
November 2020

Municipals Rally, Valuations Richen on Election, Vaccine and Supply News

Tax-exempt yields fell sharply in November and the curve flattened as long yields declined more than short. A favorable supply/demand imbalance was primarily responsible for the rally as new issue volume fell to less than $20B last month, well below the record $80B issued in the pre-election rush in October. Investor demand was strong in November with positive industry inflows each week, despite initial concerns that the likely (but not certain) election outcome of divided government would provide less fiscal stimulus than if Democrats had taken full control. Nonetheless, a compromise stimulus plan is expected in Q1 and this, combined with the very good news on the 90%+ effectiveness for various COVID-19 vaccines, boosted investor sentiment and a risk-on buyer mentality ensued. Longer-dated and lower-rated municipal issues benefited the most in the strong November rally. Already, investors are looking to 2021 where expectations of pent-up economic demand and a pathway back to normalcy should lead to higher municipal tax revenues. Municipal supply forecasts for next year span an unusually wide range, from a 14% YoY decline to a 25% increase. There is agreement, however, that taxable municipal issuance will remain robust, likely representing as much as 40% of next year's total municipal volume. If so, then tax-exempt issuance would very likely be flat to lower YoY; a view that was already helping to richen tax-exempt valuations relative to Treasuries and other taxable securities last month.

AAA Municipal Yields



Maturity	12/31/19	10/31/20	11/30/20	1Mo Δ	YTD Δ
1	1.06%	0.18%	0.14%	-0.04%	-0.92%
2	1.06%	0.20%	0.15%	-0.05%	-0.91%
3	1.07%	0.21%	0.16%	-0.05%	-0.91%
5	1.14%	0.34%	0.23%	-0.11%	-0.91%
7	1.25%	0.57%	0.39%	-0.18%	-0.86%
10	1.48%	0.94%	0.71%	-0.23%	-0.77%
30	2.15%	1.79%	1.49%	-0.30%	-0.66%

Election Outcome and the Impact on Municipals

Control of the US Senate will not be determined until the two runoff elections in Georgia are decided in early January. The market expects the GOP to retain control, leading to divided power in Washington and a low probability of sweeping policy changes, including the tax hikes the Biden campaign had run on. Nonetheless, the market was comforted by president-elect Biden's selection of former Fed chair, Janet Yellen, as Treasury Secretary. Her long experience in Washington and respect in the financial markets, not to mention her close relationship with current Fed Chair Jay Powell, all imply effective coordination of both fiscal and monetary policy in a Biden administration. Additional fiscal stimulus directed toward state and local governments, which together account for over 12% of all jobs in the U.S., is expected in Q1. And while the Trump administration decided to allow several of the special pandemic lending facilities to expire at year-end, including the Municipal Liquidity Facility (MLF), the market is confident Yellen and Powell would resurrect them again if needed. One reason for letting the MLF end is the abundant liquidity currently available. This was particularly evident last month when the State of New Jersey, the second-lowest rated state (A3/BBB+) behind only Illinois, issued $3.6B of general obligation debt into overwhelming demand. November's election also included a few key state and local initiatives, among them was the defeat of an effort to implement a graduated income tax in Illinois, while voters in Arizona did approve a 3.5% additional income tax on higher earners. Florida increased its statewide minimum wage and five more states legalized marijuana, which can be taxed similarly to alcohol or tobacco.

Strong November Returns Led by Lower-rated and Longer-dated Issues

Longer maturities significantly outpaced shorter maturities as the curve flattened. Similarly, lower-quality issues outperformed higher quality as credit spreads compressed in the rally. Not surprisingly, the Prerefunded sector lagged both GOs and Revenue issues for the month.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	November	YTD	Bloomberg Barclays Quality	November	YTD
Municipal Bond Index	1.51%	4.58%	AAA	1.33%	5.22%
General Obligation bonds	1.32%	4.99%	AA	1.37%	4.79%
Revenue bonds	1.70%	4.57%	A	1.73%	4.41%
Prerefunded bonds	0.27%	2.69%	BBB	2.03%	2.79%
Long maturities (22+ yrs.)	2.51%	5.28%	High Yield	2.40%	2.96%
Intermediate maturities (1 - 17 yrs.)	1.11%	4.23%	HY, ex-Puerto Rico	2.26%	2.11%
Short maturities (1 - 5 yrs.)	0.29%	2.63%			

Disclosures

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.

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.

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