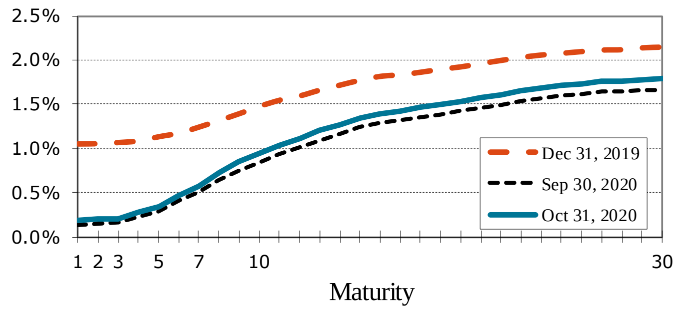
Baird Advisors
Municipal Fixed Income Market Commentary
October 2020

Yields Higher, Curve Steepens as Election Approaches

Tax-exempt yields moved higher in October in sympathy with rising Treasury rates and record municipal supply. Short rates rose just 5 bps, limited by the Fed's anchoring of short rates near zero, while longer yields rose 12 bps leading to a steeper curve. As the curve has steepened in recent weeks, the roll-down benefit becomes an increasingly important source of return, particularly in the 5 to 9-year maturity segment for short to intermediate-term investors. Heavy refinancing activity prior to the uncertain election drove much of the record issuance this month. For example, 30yr tax-exempt rates are still roughly 75 bps below the 3-year trailing average, suggesting that refinancing activity should continue if rates remain relatively low. Total long-term municipal supply in October (ex-short-term notes), rose to $80B, surpassing the previous monthly record of $72B in December 2017, just prior to the passage of the tax-reform bill. Of October's total issuance, $34B (43%) was taxable, the majority targeted at advance refunding outstanding tax-exempt debt (another quirk of the 2017 tax bill). YTD taxable issuance of $166B (38% of total 2020 volume) exceeds the previous annual record of $159B set in the Build American Bond (BAB) issuance period of 2010. Investor demand was steady and robust last month as municipal fund inflows helped absorb the supply. Approximately $5B of net tax-exempt mutual fund inflows occurred in October, bringing the YTD total to $25.6B.

AAA Municipal Yields



Maturity	12/31/19	9/30/20	10/31/20	1Mo Δ	YTD Δ
1	1.06%	0.13%	0.18%	0.05%	-0.88%
2	1.06%	0.15%	0.20%	0.05%	-0.86%
3	1.07%	0.16%	0.21%	0.05%	-0.86%
5	1.14%	0.29%	0.34%	0.05%	-0.80%
7	1.25%	0.51%	0.57%	0.06%	-0.68%
10	1.48%	0.84%	0.94%	0.10%	-0.54%
30	2.15%	1.67%	1.79%	0.12%	-0.36%

Stimulus Delayed but Municipalities Show Resilience

The election results will (hopefully) be known soon, although it could be January before we have the final tally in the Senate. Hopes for an October stimulus agreement were not met, pushing back any agreement now to the post-election period, most likely Q1. Fortunately, official tax receipts for the first nine months of 2020 have fared better than expected. According to the Bureau of Economic Analysis, data in the recently released Q3 GDP report showed that individual income taxes actually rose 5.4% YoY, no doubt helped by the unprecedented fiscal support received. Stable home prices also led to higher property tax receipts, which rose 3.9% YoY. Sales taxes fell, not surprisingly, given the economic contraction, but were down just 4% YoY. If California and New York, two large bellwether states, are any indication many states were perhaps too conservative in their budget projections as each collected more tax revenue than expected last quarter. To be fair, Covid-19 cases have recently spiked once again in many states and further economic gains may slow or perhaps reverse in coming months. But the recent data is encouraging, particularly given the cost cutting measures municipalities have taken and the level of reserves most still have in place. Nonetheless, any additional fiscal stimulus will be very welcome to help support and solidify the recovery. In other municipal credit news – hospitals received good news last month regarding the repayment of Medicare advancements, received as part of the CARES Act. These payments, which provided much needed liquidity during the worst of the pandemic, were scheduled to be repaid by offsetting Medicare claims starting 120 days after receipt. Now, repayments can be extended for a full year, with just 25% repaid in the subsequent 11 months and 50% over the next 6 months. This change effectively provides a full 29 months to repay the amount in full.

Short Maturity, Lower-Rated Fared Best in October

There were little sector differences this month, but longer maturity bonds lagged shorter issues as the curve bear-steepened. Although returns were negative in October, returns remain solidly positive YTD. Lower-quality issues fared better than higher-rated debt as the additional income of High Yield securities helped insulate investors against the small change in rates.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	October	YTD	Bloomberg Barclays Quality	October	YTD
Municipal Bond Index	-0.30%	3.02%	AAA	-0.38%	3.84%
General Obligation bonds	-0.29%	3.61%	AA	-0.33%	3.37%
Revenue bonds	-0.31%	2.82%	A	-0.19%	2.63%
Prerefunded bonds	-0.21%	2.41%	BBB	-0.24%	0.75%
Long maturities (22+ yrs.)	-0.43%	2.70%	High Yield	0.18%	0.54%
Intermediate maturities (1 - 17 yrs.)	-0.25%	3.09%	HY, ex-Puerto Rico	0.09%	-0.14%
Short maturities (1 - 5 yrs.)	-0.15%	2.33%			

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.