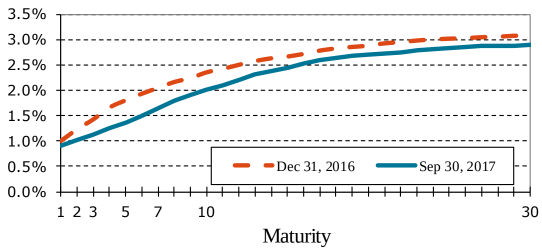
Baird Advisors
Municipal Fixed Income Market Comments
September 2017

September Rate Increase Leads to Marginally Higher Q3 Yields

More hawkish rhetoric from Fed Chair Yellen than had been expected along with the start of the tax reform debate pushed tax-free yields higher in September, and for the quarter. Yields rose 25 bps in the 5-year maturity range last month, more than any other part of the curve. New issue volume for the quarter was 26% below Q3 last year, due to a decline in refunding activity. Demand was strong as mutual fund flows were positive for 11 consecutive weeks into quarter end. The municipal market is, however, paying close attention to the recently released Trump/GOP tax reform outline, despite the fact that historically there has been little correlation between the change in marginal income tax rates and municipal valuations. It was noteworthy that the reform blueprint left open the option of a fourth, higher, income tax bracket, in addition to the three proposed (12%, 25%, and 35%). Many details of the plan are yet to be worked out and will be left to the two tax writing committees in Congress. Thankfully, senior administration officials have confirmed their support for maintaining the municipal tax exemption since municipal borrowing will continue to play a vital role in future infrastructure financings. In fact, President Trump recently reversed his previously positive views on P3's (public-private-partnerships), now saying they "don't work." The President opened the door instead for more direct federal spending and additional debt for meeting infrastructure needs, bringing his position more in line with traditional Democratic policy views.

AAA Municipal Yields



Maturity	Dec 31, 2016	Jun 30, 2017	Aug 31, 2017	Sep 30, 2017	1Mo Change	3Mo Change	YTD Change
1	1.00%	0.84%	0.76%	0.92%	0.16%	0.08%	-0.08%
2	1.23%	0.99%	0.85%	1.02%	0.17%	0.03%	-0.21%
3	1.43%	1.11%	0.94%	1.13%	0.19%	0.02%	-0.30%
5	1.80%	1.35%	1.12%	1.37%	0.25%	0.02%	-0.43%
7	2.05%	1.60%	1.42%	1.64%	0.22%	0.04%	-0.41%
10	2.35%	1.96%	1.84%	2.00%	0.16%	0.04%	-0.35%
30	3.08%	2.81%	2.74%	2.90%	0.16%	0.09%	-0.18%

Credit Updates

Clean-up and cost estimates were still underway in Texas and Florida following the damage from Hurricanes Harvey and Irma, when Hurricane Maria, the third Category 4 hurricane to hit the U.S. in a month, struck Puerto Rico. Power was lost across the entire island and it may be months before it is completely restored. Certainly, humanitarian aid is the first priority, but once stabilized, the impact of the storm will only further strain the financial challenges Puerto Rico and its' bondholders face. For example, Puerto Rico's general obligation bonds, likely to have the highest priority for repayment, traded below $50 in the aftermath of the hurricane. Because of its limited resources, the cost of repairing and rebuilding Puerto Rico will fall almost entirely on FEMA, a role the federal government has increasingly assumed since Hurricane Katrina struck New Orleans in 2005.

A storm of a different type is brewing in Connecticut, where Democratic Governor Malloy recently vetoed a Republican-led biennial budget that passed the General Assembly. The state has been operating under an Executive Order since July 1st. Meanwhile, Hartford, the state capitol, is drawing closer to a Chapter 9 bankruptcy filing or at the least a debt restructuring. Hartford's mayor has begun negotiations with bondholders to reduce the city's debt burden. The monoline insurers, which back over 80% of Hartford's outstanding debt, have offered to extend maturities and smooth debt service costs, but the Mayor appears to want even greater concessions. It's not certain that Hartford can prove it is insolvent, a necessary step prior to bankruptcy.

Negative September Returns, but Positive for Q3

All segments of the yield curve and market sectors suffered a setback in September as tax-free yields rose, yet returns for the third quarter remained solidly positive. Longer maturity issues lagged the returns of intermediate and shorter curve segments, but remained the best performer for the full quarter. Accepting credit risk paid off for the quarter, particularly so for BBB-rated issues which outperformed as credit spreads narrowed.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	September	3Mo	YTD
Municipal Bond Index	-0.51%	1.06%	4.66%
General Obligation bonds	-0.48%	1.14%	4.65%
Revenue bonds	-0.54%	1.10%	4.99%
Prerefunded bonds	-0.33%	0.38%	1.92%
Long maturities (22+ yrs.)	-0.70%	1.23%	5.83%
Intermediate maturities (1 - 17 yrs.)	-0.46%	0.93%	4.17%
Short maturities (1 - 5 yrs.)	-0.32%	0.49%	2.27%

Bloomberg Barclays Quality	September	3Mo	YTD
AAA	-0.62%	0.71%	3.92%
AA	-0.56%	0.84%	4.28%
A	-0.49%	1.23%	5.22%
BBB	0.05%	2.79%	7.23%
High Yield	-0.54%	1.50%	7.72%
HY, ex-Puerto Rico	-0.44%	2.00%	10.35%

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.