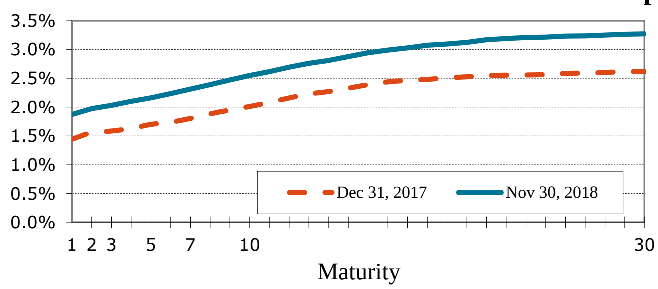
Baird Advisors
Municipal Fixed Income Market Commentary
November 2018

Outflows Persist but Municipals Rally on Light Supply

The municipal market rallied last month as yields fell across the tax-free curve, even outperforming comparable maturity Treasuries which were supported by softer inflation data and a more dovish Fed tone. The largest yield declines occurred in the 7 – 10 year segment where rates fell 21 bps. The result was a flatter curve, as intermediate rates fell more than short-term yields, reversing some of the YTD steepening. The relative strength of the municipal market occurred despite persistent fund outflows, as tax-free funds faced ten consecutive weeks of redemptions; investors are harvesting tax-losses due to the rise in rates, and decline in NAVs, this year. Light new supply helped to offset the fund outflows as issuance last month was approximately one-half the level from the same month last year. To be fair, issuance ballooned late in 2017 when municipalities rushed to market ahead of the looming tax reform bill. Nonetheless, November's issuance was still off 34% from October's level, causing YTD issuance to fall 18% behind 2017's pace. We expect supply to improve somewhat in 2019 assuming the economy continues to expand and tax revenues remain robust. New money borrowings have risen 21% YoY as municipalities feel more comfortable tackling their infrastructure needs. Voters appear generally willing to fund the construction needs as they arise, evident in the success of ballot initiatives in the recent elections (see below).

AAA Municipal Yields



Maturity	Dec 31, 2017	Sep 30, 2018	Nov 30, 2018	1Mo	YTD
1	1.44%	1.92%	1.87%	-0.10%	0.43%
2	1.56%	1.98%	1.98%	-0.10%	0.42%
3	1.59%	2.07%	2.03%	-0.12%	0.44%
5	1.70%	2.23%	2.16%	-0.16%	0.46%
7	1.80%	2.42%	2.31%	-0.21%	0.51%
10	2.01%	2.62%	2.55%	-0.21%	0.54%
30	2.62%	3.26%	3.27%	-0.17%	0.65%

Midterm Election Results

As was widely expected, the chambers of Congress are now divided. Democrats took control of the U.S. House, gaining 39 seats, while Republicans added to their majority in the Senate, picking up 4 seats. Passage of major new legislation becomes even more challenging than when Republicans alone were in control, but perhaps sufficient common ground will be found in a few key areas, with infrastructure being at the top of most wish lists. The next chair of the House Ways and Means Committee is expected to be Richard Neal (D-MA), a former mayor (Springfield, MA) who understands the important role that the municipal market can play in helping to finance state and local infrastructure needs. It's even possible that the restriction on advance refunding of outstanding municipal debt could get revisited if an infrastructure plan is considered. The number one concern voters cited in the election was health care, but a divided Congress is unlikely to produce major changes at the federal level although state and local changes will continue. For example, four states (ID, NE, UT, and OR) approved the expansion of Medicaid, which provides additional federal money for rising state healthcare expenses.

Democrats also gained ground at the state level as they won seven gubernatorial spots, narrowing the Republican governor advantage across the country to +4 (27 to 23). Perhaps the most important outcome from the recent election, at least from the perspective of the municipal market, was the approximately $31.5B of bond ballot measures that passed. Texans were in a particularly supportive mood, voting in favor of 97% of their bond measures which should lead to a total of $8.7B of new borrowing in the future.

Long End and Higher Quality Outperform

The rally in rates last month led to positive returns across the municipal market with long-term maturities outperforming shorter segments of the curve. Performance across all market sectors was positive, although Prere's lagged given their relatively short average maturity. Within credit quality, there was little difference in performance across investment grade rated issues, but the High Yield municipal debt lagged, perhaps in sympathy with wider credit spreads in the taxable corporate market.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	November	3mo	YTD
Municipal Bond Index	1.11%	-0.17%	0.08%
General Obligation bonds	1.16%	-0.10%	0.10%
Revenue bonds	1.14%	-0.22%	-0.02%
Prerefunded bonds	0.54%	0.11%	0.96%
Long maturities (22+ yrs.)	1.26%	-0.79%	-1.02%
Intermediate maturities (1 - 17 yrs.)	1.02%	0.04%	0.47%
Short maturities (1 - 5 yrs.)	0.51%	0.09%	1.13%

Bloomberg Barclays Quality	November	3mo	YTD
AAA	1.18%	-0.05%	-0.17%
AA	1.12%	-0.12%	0.01%
A	1.04%	-0.26%	0.12%
BBB	1.11%	-0.37%	0.90%
High Yield	0.70%	-0.95%	3.86%
HY, ex-Puerto Rico	0.62%	-1.16%	2.71%

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.