

Municipal Bond Market Weekly

Bottom Line:

- Treasury market yields fell slightly as multi asset class implied volatilities reach the lowest levels since 2014 and the Citi Economic Surprise Index is at one year low levels.
- Municipal yields outperformed Treasuries with the 10yr AAA GO Ratio hitting the lows of the year.
- The State of CT ratings cut by Fitch and Hartford, CT seeking Chapter 9 counsel.
- Municipal bond holder-ship has transitioned increasingly toward banks, insurance companies, foreign investors and funds from individual bond holders.
- Municipal bond fund flows were positive for the fifth consecutive week.
- Creditors and Debtors of Puerto Rico to have first meeting under Title III restructuring process.
- S&P Puerto Rico Total Return Index was -3.2% last week; -3.8% YTD.

What Happened in the Bond Markets Last Week?

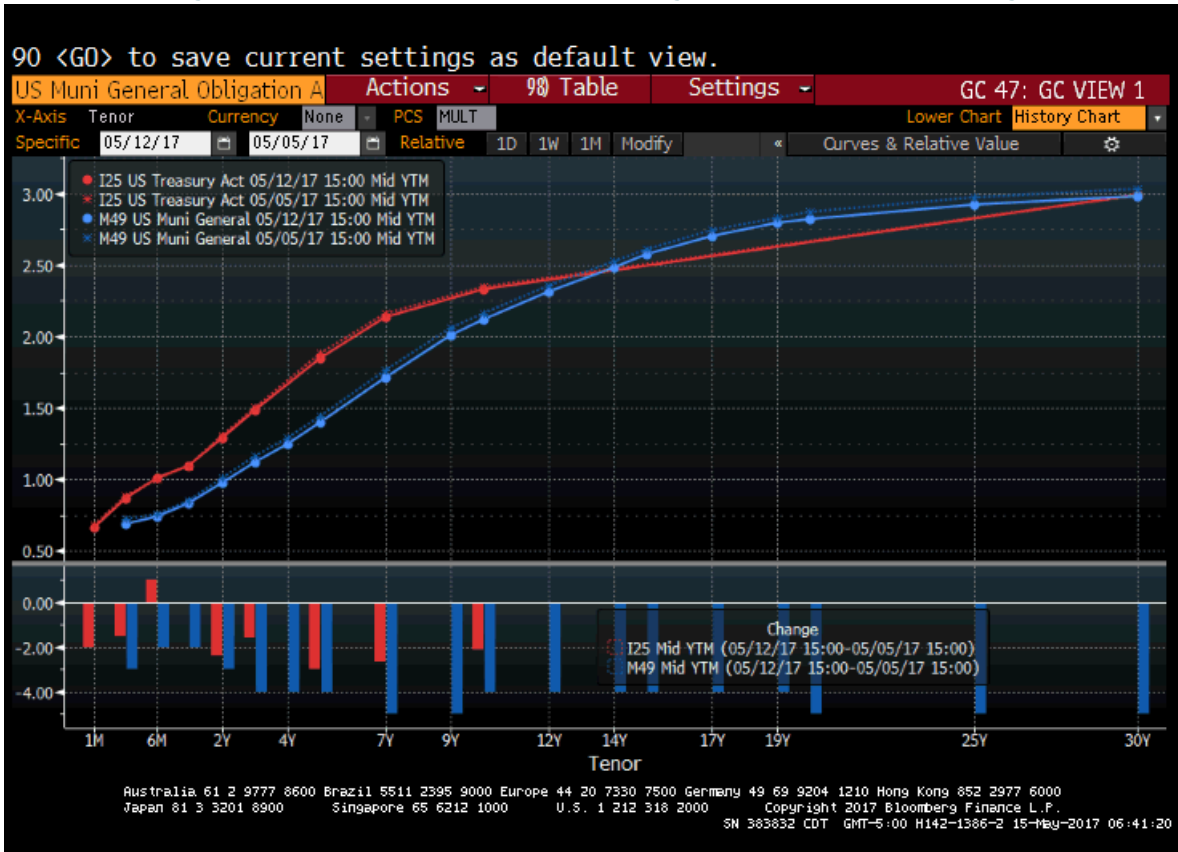
- Last week, Treasury yields fell only slightly in another low volatility week (implied and realized). In fact the BofA Merrill Lynch GFSI Market Risk Index that measures the implied volatility of many asset classes is at the lowest level since mid-2014. Even a week of controversy out of Washington and continued weakness in economic data (PPI, CPI, Retail Sales, relative to expectations (the Citi Economic Surprise Index now at the lowest level in one year) moved Treasury yields only slightly lower.
- Municipal yields outperformed Treasuries and the 10yr GO Ratio hit the lowest (most expensive) level of the year and the 5 year AAA GO Ratio reached the lowest level since August 2016.

Yields (Figure 1):

- For the week ending 5/12/17 Treasury yields traded lower; 2-year Treasury Note yields -2.4 bps to 1.29%, 5-year Notes yields were -3 bps to 1.85%, 10-year Notes yields were -2.1 bps to 2.33% and 30-year bonds yields were unchanged at 2.99%.
- Bloomberg Municipal Index curve yields traded lower: AAA-rated GO yields; 2-year bonds were -3 bps to 0.98%, 5-year bond yields were -4 bps to 1.40%, 10-year bond yields were -4 bps to 2.12% and 30-year bonds were -5 bps at 2.98%.
- The Ratio of 10-year AAA GO debt to 10-year Treasury yields fell markedly to 91.3 from 92.0 last week. The year-to-date average is 94.8 and the 12-month average is 94.2.

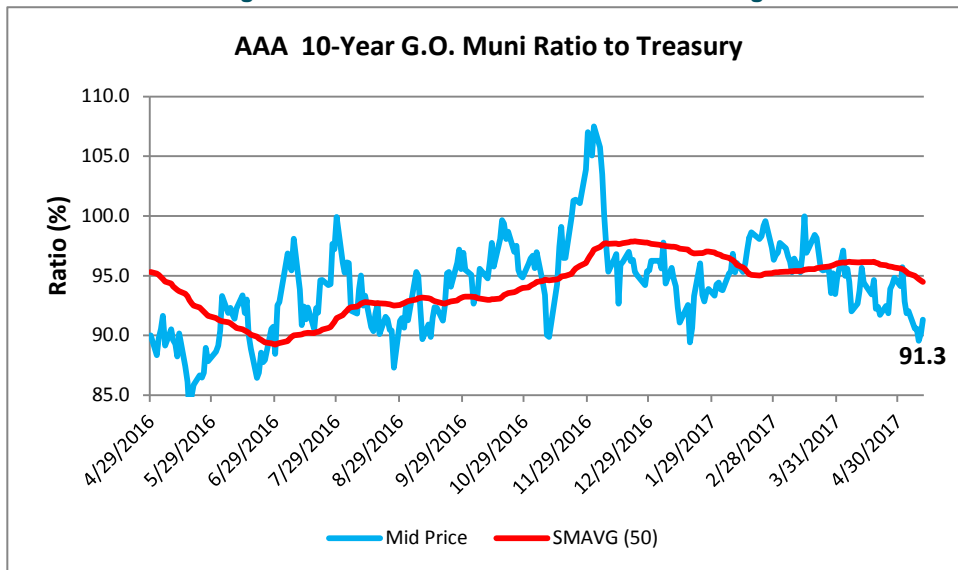
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Figure 1 - Yield Curve and Muni Curve Changes – Data Source: Bloomberg



One can observe these changes by looking at how rates have changed along the curve for both the Treasury curve and for the AAA-rated G.O. Index since last week. The top panel shows four yield curves; two for the Treasury curve (in red) - one for the most current date and one from last week and two for the AAA-rated G.O. (in blue) - current and last week. The bottom panel of the graph shows changes in the rates along both curves for the week for both Treasuries and the AAA G.O. Index.

Figure 2 - Muni Ratio – Data Source: Bloomberg

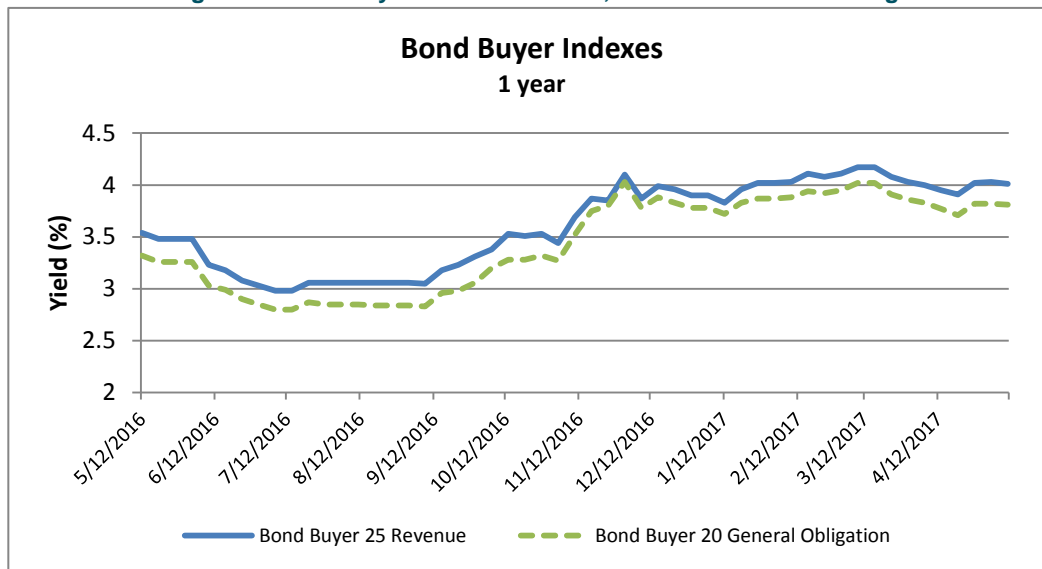


Bond Buyer Indexes (Table 1 and Figure 3): Last week, the Bond Buyer Index yields were slightly lower: Bond Buyer 20-GO Index was -1 bps to 3.81% and the 25-Revenue Index yield was -2 bps to 4.01%.

Table 1 - Bond Buyer Indexes – Source: Bloomberg

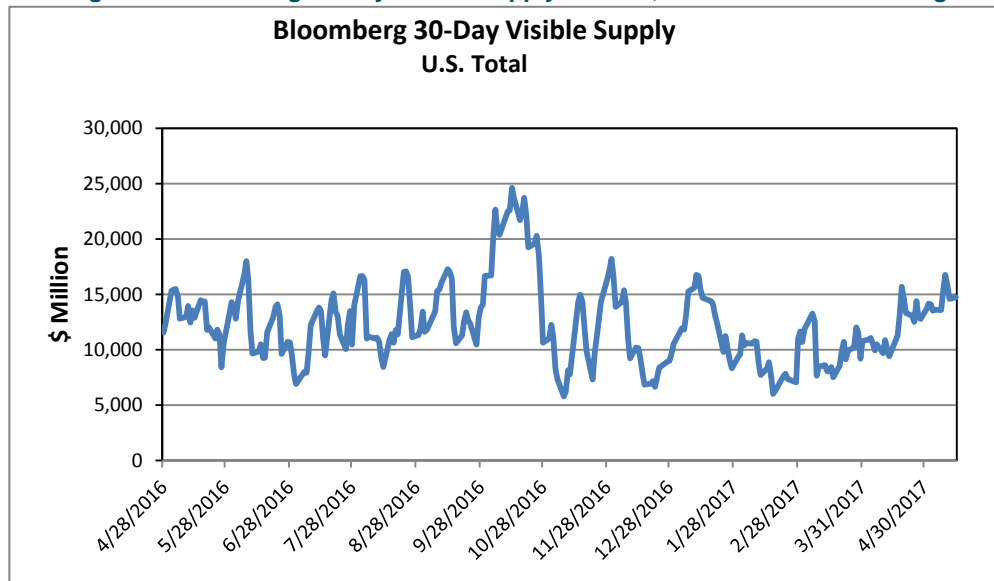
Index	Yield %	Yield Last Week	1 Week Change (bps)	Yield 1 Month Ago	1 Month Change (bps)
Bond Buyer 20 Gen'l Obligation Index	3.81	3.82	-1.0	3.83	-2.0
Bond Buyer 11 Gen'l Obligation Index	3.32	3.33	-1.0	3.34	-2.0
Bond Buyer 25 Revenue Index	4.01	4.03	-2.0	4	1.0

Figure 3- Bond Buyer Indexes - 1 Year; Data Source: Bloomberg



Supply (Figure 4) – Bloomberg 30-Day Visible Supply currently stands at \$14.8 billion down from \$13.6 billion this time last week. The YTD average visible supply is \$11.3 billion and the 12-mo average is \$12.4 billion.

Figure 4- Bloomberg 30-Day Visible Supply - 1 Year; Data Source: Bloomberg



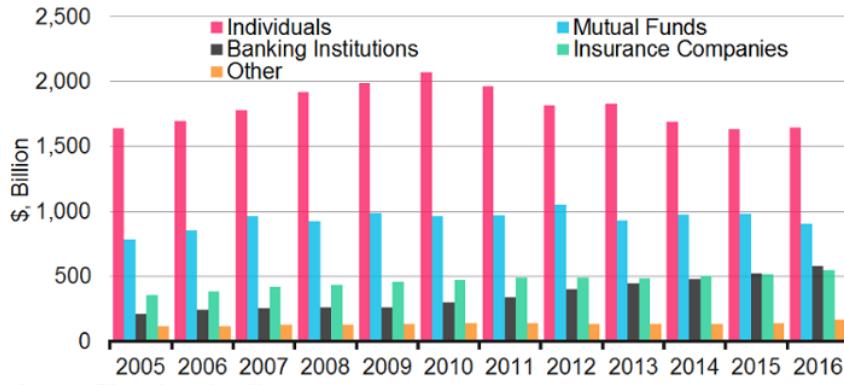
Articles of Interest

Municipal Fund Flows: According to Lipper data municipal for a fifth consecutive week bond funds had net inflows for the past week of \$605.7 million after \$127.8 million during the previous week. The four-week moving average is \$292.1 million. High-yield funds reported net inflows.

Connecticut Credit Rating Cut and Hartford, CT Considers filing Chapter 9:

- o Fitch credit rating was cut by Fitch Ratings to A+ (from AA-) as the state’s budget difficulties continue. S&P has AA- (negative outlook) and Moody’s has an Aa3 (negative outlook) on the state’s general obligation bonds.
- o Hartford, CT is soliciting law firm proposals that specialize in Chapter 9 bankruptcy as the city mulls the possibility due to its deficit and debt load. Currently, the city has a credit rating of Ba2 with a negative outlook from Moody’s and says that further downgrades are possible if there is continued lack of progress on budget gaps.

Municipal Bond Holders (Bloomberg Brief)(graph below): Since 2005 the proportion of individual bonds held by individuals has declined as the proportion held by institutions and ETFs has increased. The largest proportional increase has come from banks and insurance companies (rising by 98 percent). Tax-related incentives boosted the demand by banks. Additionally, longer maturity bonds have been increasingly in demand by insurance companies, particularly life insurance, for asset-liability management. And despite the inability of foreign investors to capitalize on tax-exemption, low global yields have prompted demand by foreign investors.

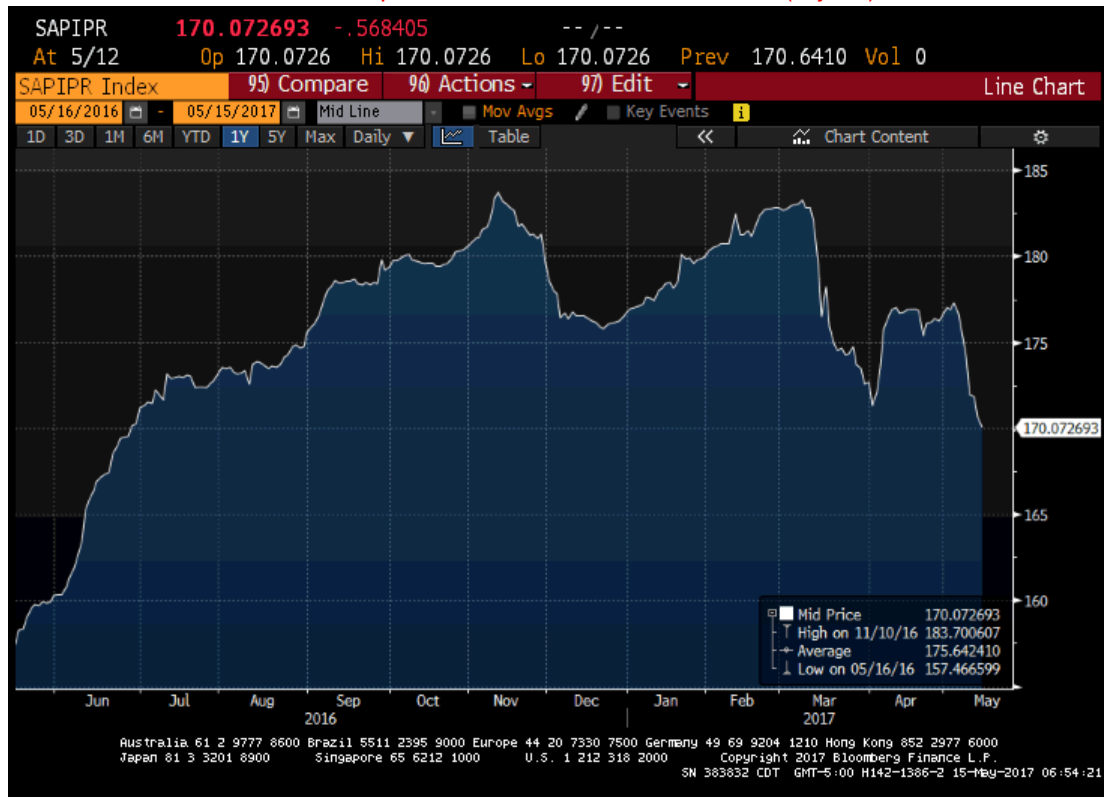


Source: Bloomberg Intelligence

Puerto Rico:

- o **Meeting Set for May 17th:** Puerto Rico and creditors will meet to begin restructuring discussions for the first time since General Obligation debtors and COFINA debtors filed under Title III last week. Representing creditors will be hedge funds, bond insurers and mutual funds. Key disputes will likely arise between pensioners (\$49 billion of unfunded liabilities) and other creditors; between general obligation bond holders and COFINA and potentially between senior and subordinate COFINA bondholders. Some restructuring attorneys believe that the entire restructuring process may take as long as several years to complete.
- o **The S&P Municipal Bond Puerto Rico Index** finished at 170.1 on Friday vs. 175.6 at the end of the previous week, -3.2%. Year-to-date the index is -3.8%.

S&P Municipal Bond Puerto Rico Index Level (1-year)

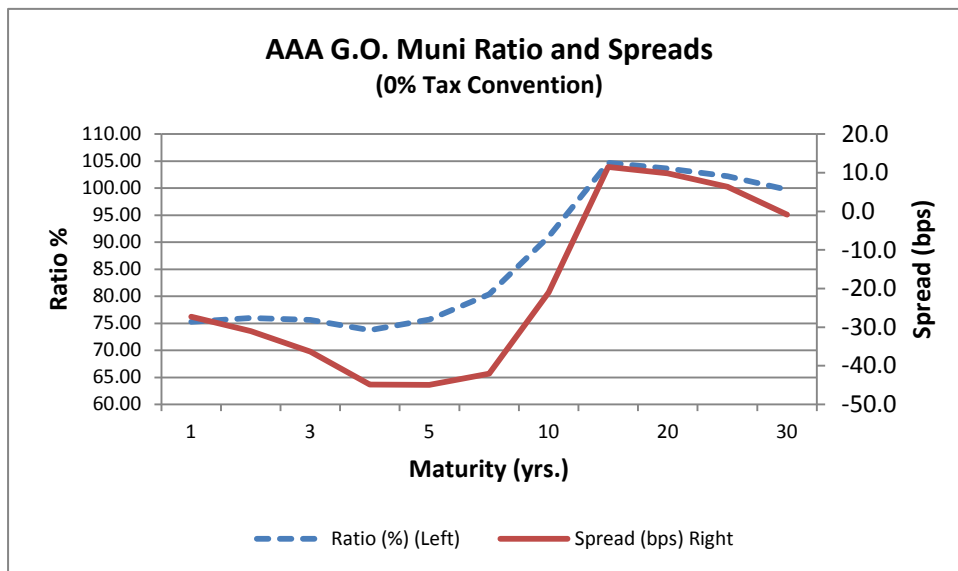


Relative Value by Maturity

Table 2 - AAA Muni Ratios and Spreads by Maturity - Data Source: Bloomberg

5/15/2017	Yield-to-Maturity (%)		0% Tax Rate		35% Tax Equivalent	
Maturity (yrs.)	AAA Gen. Oblig.	Treasury	Spread (bps)	Ratio (%)	Spread (bps)	Ratio (%)
1	0.83	1.10	-27.3	75.3	17.5	115.8
2	0.98	1.29	-31.1	76.0	21.8	116.9
3	1.13	1.49	-36.3	75.6	24.3	116.3
4	1.26	1.71	-44.8	73.8	23.0	113.5
5	1.40	1.85	-45.0	75.7	30.5	116.5
7	1.72	2.14	-42.0	80.3	50.4	123.6
10	2.12	2.33	-21.0	91.0	93.3	140.0
15	2.58	2.46	11.5	104.7	150.1	161.0
20	2.83	2.73	9.9	103.6	162.2	159.4
25	2.93	2.86	6.3	102.2	164.0	157.3
30	2.99	3.00	-0.9	99.7	160.0	153.4

Figure 5 – AAA General Obligation Ratios and Spreads – Data Source: Bloomberg



Relative Value by Rating

Figure 6 – Muni Index Yield Curve by Credit Rating – Data Source: Bloomberg

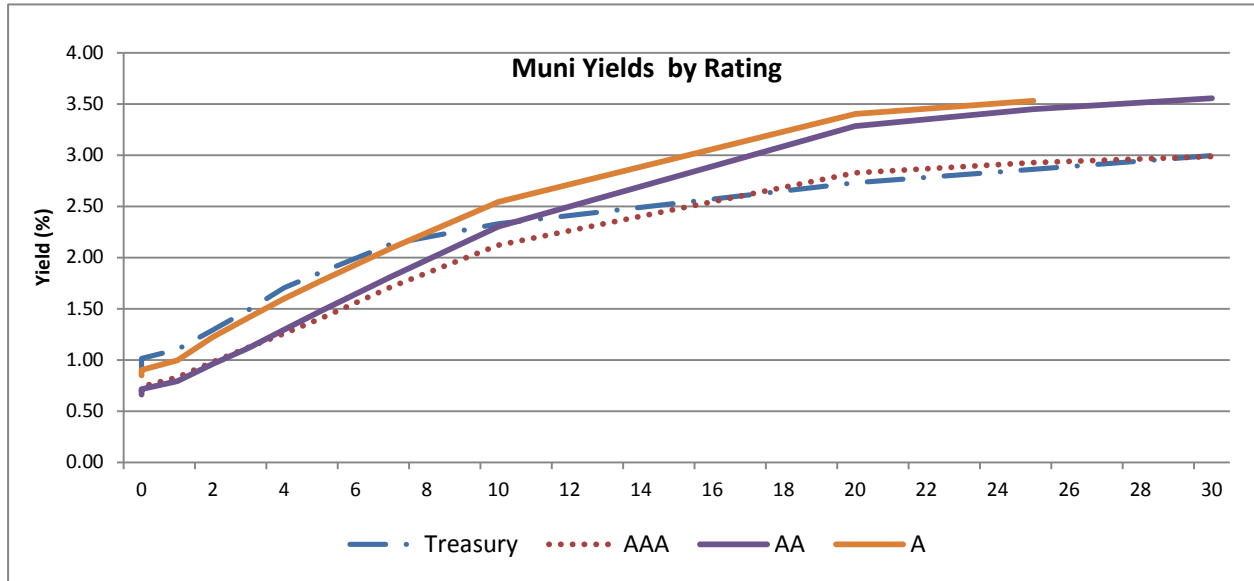


Figure 7 – Muni Index Ratios by Maturity and by Credit Rating – Data Source: Bloomberg

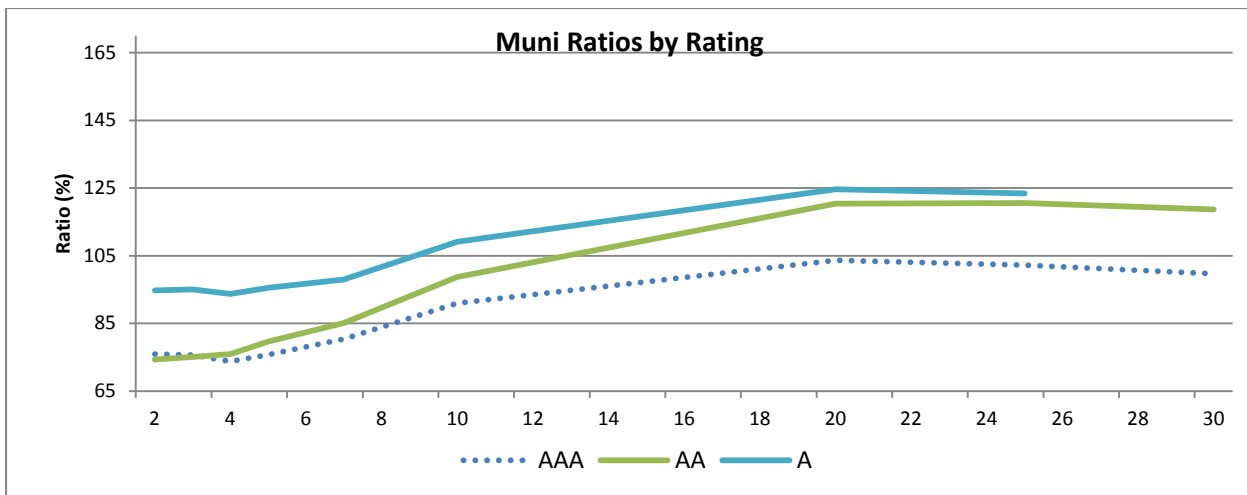
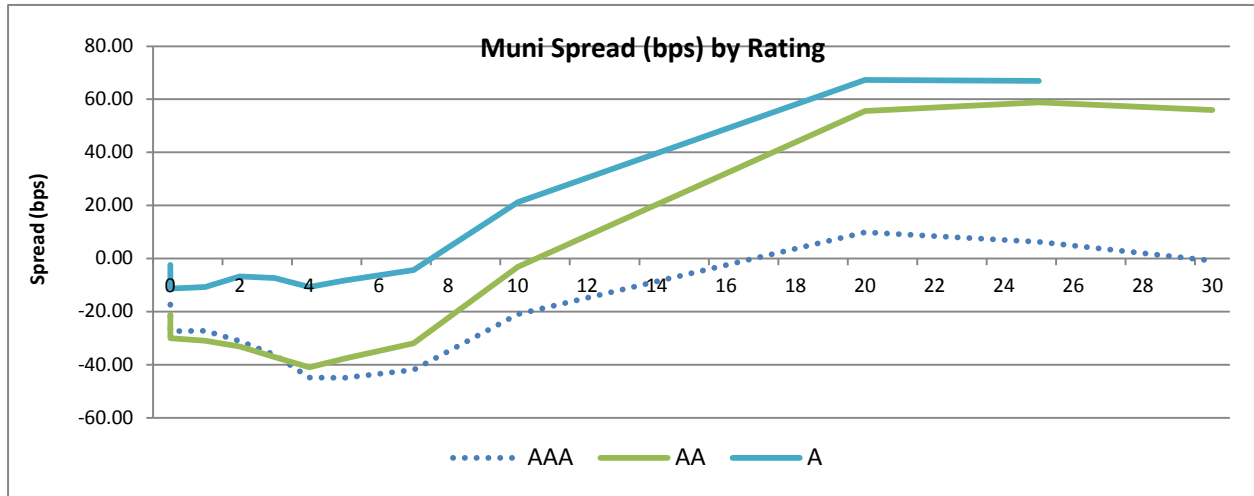


Figure 8 – Muni Index Spread to Treasuries by Maturity and by Credit Rating– Data Source: Bloomberg



For more information please contact your Financial Advisor.

Appendix – Important Disclosures

Some of the potential risks associated with fixed income investments include call risk, reinvestment risk, default risk and inflation risk. Additionally, it is important that an investor is familiar with the inverse relationship between a bond's price and its yield. Bond prices will fall as interest rates rise and vice versa.

When considering a potential investment, investors should compare the credit qualities of available bond issues before they invest. The two most recognized rating agencies that assign credit ratings to bond issuers are Moody's Investors Service ("Moody's") and Standard & Poor's Corporation ("S&P"). Moody's lowest investment-grade rating for a bond is Baa3 and S&P's lowest investment-grade rating for a bond is BBB-. Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest).

The Bond Buyer 20-Bond Index consists of 20 general obligation bonds that mature in 20 years. The average rating of the 20 bonds is roughly equivalent to Moody's Investors Service's Aa2 rating and Standard & Poor's Corp.'s AA. The Bond Buyer 11-Bond Index uses a select group of 11 bonds in the 20-Bond Index. The average rating of the 11 bonds is roughly equivalent to Moody's Aa1 and S&P's AA-plus. The Bond Buyer Revenue Bond Index consists of 25 various revenue bonds that mature in 30 years. The average rating is roughly equivalent to Moody's A1 and S&P's A-plus. The indexes represent theoretical yields rather than actual price or yield quotations. Municipal bond traders are asked to estimate what a current-coupon bond for each issuer in the indexes would yield if the bond was sold at par value. The indexes are simple averages of the average estimated yields of the bonds, are unmanaged and a direct investment cannot be made in them.

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