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Golf and the Municipal Market

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"Golf is deceptively simple and endlessly complicated: it satisfies the soul and frustrates the intellect. It is at the same time rewarding and maddening – and it is without a doubt the greatest game mankind ever invented."

– Arnold Palmer

As anyone who has played the game of golf knows, it can be both fun and frustrating at the same time. While it may look easy to someone unfamiliar with the game – after all, what's so hard about hitting a stationary ball off a well-groomed surface in a wide-open environment, with few distractions and no time limit? Yet, as any golfer knows it's not nearly as easy as it looks. Even the best, most experienced golfers hit errant shots that land in sand traps, go out of bounds, get lost in the rough, and even, on occasion, hit spectators. Understanding and perfecting the mechanics of the golf swing is challenging enough, but mastering the mental aspect can be even more difficult. A love-hate relationship with the game of golf is not unusual, even among those who play it often.

Investing is like golf at times. It can be both simple and complicated; satisfying when things go well and frustrating when they don't. Yet, one of the most rewarding endeavors ever, particularly for those who can master the mental aspect. These truisms apply to all types of investing, of course, but particularly so for those who invest in the fixed income markets. For an asset class in which the dual objectives of principal safety and income are dominant, investing can seem overly complicated, particularly the municipal market which is primarily the focus of individuals rather than institutions.

Municipals – A Diverse and Complex Market

For many years the municipal market was perceived to be a relatively simple (even sleepy) fixed income sector. Credit quality was often a secondary concern, since most issues were perceived to be of high quality and those that weren't were often wrapped with AAA-rated insurance. An investor's primary focus instead was the maturity and state of issuance of a bond in order to maximize tax efficiency when possible. The "sleepy" municipal market changed for good after the financial crisis of 2008. Insurance guarantees essentially disappeared, and maturity and state tax concerns were reduced in favor of credit quality, which took center stage. Perhaps the greatest change that occurred post-crisis, however, was the increased investor awareness to the great diversity and complexity of the municipal market.

Investors understood, perhaps for the first time, that the municipal market, with over $3.6 trillion in debt outstanding, spread among more than 60,000 unique issuers across the country, with more than 1 million different individual securities, is both diverse and complex. The fact that there is no centralized trading exchange, as there is for equities, only adds to the market's complexity. Instead, it is a "negotiated" market, allowing for price differences on the same bond trading at the same time, perhaps even from the same dealer. The dealer network itself is fragmented as well. On any business day over one hundred dealers may be actively involved in the primary or secondary municipal markets, or both, marketing and trading securities to both individuals and institutions. Little wonder that investors can get confused and lost in the municipal maze.

Baird Benefits from Market Complexity

Yet, with complexity comes opportunity. Rather than getting frustrated and giving up the game, investors can take advantage of the market inefficiencies by hiring an experienced manager to keep the ball in bounds. A professional manager who understands the nuances of the market can capture excess yield and return by capitalizing on the inefficiencies of the municipal market. The professional understands not only why the inefficiencies occur, given the sheer number of issuers, the fragmented dealer network and the diversity of security sizes, maturities and structures, but how to take advantage of these opportunities for the benefit of their clients.

Unlike the taxable fixed income market, which is dominated by institutional investors, retail investors are the dominant player in the municipal market. As of June 30, 2015, two-thirds of all municipal debt outstanding was owned by retail investors, either directly or indirectly through funds and ETFs. As in golf, where the occasional player is at a competitive disadvantage to the professional, professional investors also hold an edge in the municipal market. The good news for all investors, however, is that the market inefficiencies are largely structural in nature, suggesting that a long-term, core allocation to the sector may be appropriate for many investors. The recent, well-publicized credit challenges of a select group of fiscally troubled municipalities (e.g. Detroit, Chicago, and Puerto Rico), only enhances the investment opportunity for astute fixed income investors who are able to evaluate the credit metrics for each municipality.

Baird Advisors, the fixed income management division of Robert W. Baird & Co. Incorporated, (Baird) is well-positioned to capitalize on the inefficiencies of the municipal market. The core members of the fixed income team have successfully managed portfolios on behalf of their clients for nearly three decades and have added key personnel in both the taxable and tax-free sectors along the way. At more than $34 billion in fixed income assets under management, Baird Advisors has both the resources and the expertise to identify and capture the municipal market opportunities for clients.

Baird Advisors' "Focused" and "Full-Market" Municipal Approach

The rules of golf allow a player to carry a maximum of fourteen clubs in the golf bag during a round, but golfers often choose to carry fewer clubs as a matter of preference. For example, beginners to the game may start with a "short set," which typically includes just five to seven clubs. Even experienced players may narrow the number of clubs in their bag to just those with which they are most comfortable. Fewer clubs allows them to focus on other important aspects of their game, such as the swing and stance, rather than club selection. Playing within their comfort zone, while arguably a more conservative approach to the game, may make for a more enjoyable round, perhaps avoiding many of the hazards of the course.

Baird Advisors has a focused municipal strategy that aligns well with the concept of a narrower focus; choosing from a narrower list of market sectors and individual securities. **The Baird Quality Intermediate Municipal Bond Fund** (Quality Fund) narrows the list of issues from which it selects bonds to the highest quality sectors and credits. For example, at the end of the second quarter, 2015, over 50% of the focused fund's holdings were in the U.S. government-backed sector (pre-refunded and escrowed-to-maturity) and another 30% in general obligation credits, historically viewed as the safest sector other than government debt. The fund is also narrowly focused on the highest rated individual securities. At the same date, over 95% of the focused fund's holdings were rated AA or higher. So for those investors who want to participate in the municipal market but are most comfortable with just the highest quality securities, the **Baird Quality Intermediate Municipal Bond Fund** may be the right choice.

At the same time, many golfers, amateurs and professionals alike, prefer having the full set of clubs at their disposal. They understand that there may be a point in the golf round in which any of the fourteen clubs may be most appropriate. They want to give themselves the widest selection of club choices to enhance their score. The **Baird Core Intermediate Municipal Bond Fund** (Core Fund) provides the same opportunity for investors. Rather than a focused approach, the core fund considers the full spectrum of municipal sectors and credits. In addition to the government-backed and general obligation sectors of the focused fund, the core fund will also pay particular attention to revenue-backed issues. The revenue-backed sector of the market includes a broad array of bonds back by various revenue streams, such as: electric, water and sewer, sales taxes, airports, toll roads, private and public higher education, health care and many more. In addition, while the core fund will primarily target investment grade credits (from BBB to AAA), at times even below investment grade exposure may be appropriate. The full-market approach is intended to, over time, enhance both the yield and return for investors relative to the focused approach, with slightly more risk.

Play the Game Your Way

The beauty of both golf and investing is that each participant is able to play their own game. Each person has the choice of a more aggressive or more conservative style of play, even varying between the two styles at different times. Baird's municipal strategies offer investors that choice as they expand their fund lineup to meet the growing needs for tax-free income. In addition to the two intermediate fund choices described above, there is also now a **Baird Short-Term Municipal Bond Fund** (Short Fund) available managed in the same full-market style as the **Baird Core Intermediate Municipal Bond Fund**. The Short Fund offers investors the same broad exposure of the entire municipal market, but with a shorter target duration than either of the other two intermediate fund options. The ability to use the various Baird municipal funds either individually or in combination makes Baird a key investment partner in the municipal fixed income space going forward.

Investors should consider the investment objectives, risks, charges and expenses of each fund carefully before investing. This and other information is found in the prospectus and summary prospectus. For a prospectus or summary prospectus contact Baird Funds directly at 800-444-9102 or contact your Baird Financial Advisor. Please read the prospectus or summary prospectus carefully before investing.

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.

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