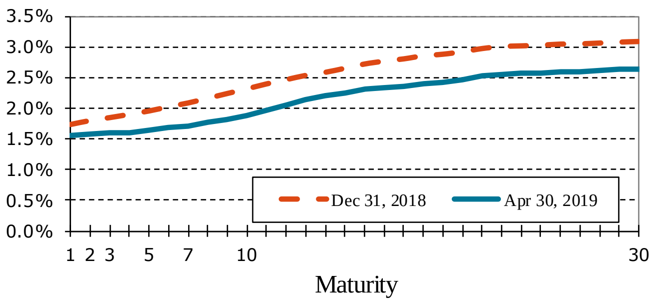
Baird Advisors
Municipal Fixed Income Market Commentary
April 2019

Muni Curve Flattens as Short Rates Rise, Long Rates Fall

Demand for tax-free funds continued at a near-record pace in April, even though April is often a weak seasonal period due to tax payment demands. Supporting the market was disappointing new supply levels as April's volume fell 28% YoY, with YTD issuance up just 3% relative to last year's pace. The strong tone pushed long-term tax-free yields down 7 bps while short-term yields *rose* 6 bps. Short-term securities were a source of liquidity for tax payments and this was most evident in the tax-exempt floating rate market, predominantly owned by money market funds. Money market fund sales pushed up the yield on the SIFMA Municipal Swap Index (a benchmark for weekly-reset floaters) by 80 bps to 2.30%, a yield equivalent to that of a 15Yr fixed-rate AAA bond. The extreme yield spike in floating rates are likely to reverse in May, but it highlights the unexpected higher tax burden investors in some states experienced given the $10,000 cap on state and local deductions. More broadly, however, the favorable supply/demand backdrop for the market shows no signs of ending. In fact, the roll-off this summer from maturities and early calls is expected to easily exceed the amount of new supply issues, providing ongoing support for municipals.

AAA Municipal Yields



Maturity	Dec 31, 2018	Mar 31, 2019	Apr 30, 2019	1Mo	YTD
1	1.74%	1.51%	1.55%	0.04%	-0.19%
2	1.80%	1.52%	1.58%	0.06%	-0.22%
3	1.85%	1.53%	1.59%	0.06%	-0.26%
5	1.96%	1.59%	1.65%	0.06%	-0.31%
7	2.09%	1.69%	1.72%	0.03%	-0.37%
10	2.32%	1.89%	1.89%	0.00%	-0.43%
30	3.09%	2.72%	2.65%	-0.07%	-0.44%

Opportunities in the Single-Family Housing Sector

Most states (and some local governments) issue bonds through a Housing Finance Authority (HFA) in an effort to support and promote home ownership. This occurs by offering below-market fixed rate mortgages and/or down payment assistance for first time home buyers. The credit quality of these programs is generally very high. Most of the mortgages in the HFA pool (if not all) are guaranteed by U.S. federal agencies (e.g. Ginnie Mae, Fannie Mae or Freddie Mac), plus the mortgage pool itself, along with other reserves, often exceeds the amount of HFA debt outstanding, providing additional credit support through overcollateralization. One particularly attractive HFA security structure is found in Planned Amortization Class (PAC) issues. This structure reduces the risk of significant and unexpected duration drift within a wide range of prepayment expectations, providing the bondholder a higher level of confidence on the expected average maturity of the bond. A typical PAC bond, for example, may have a 5Yr expected average life, an attractive segment of the yield curve for individual investors. Yet, because of the relatively complex nature of the security structure retail investors often avoid these bonds, providing an opportunity for institutional investors to capture. The additional yield a PAC bond may offer relative to a traditional municipal bond of similar quality and in the same maturity range can be +50 bps, or more. In an environment of relatively low yields and narrow credit spreads, adding structural opportunities like this in a municipal portfolio helps to diversify the portfolio risk while still providing additional tax-free income to the investor.

Positive Month Adds to Favorable YTD Returns

April continued the favorable recent streak of positive monthly returns. Once again, longer term maturities outperformed shorter term debt as the curve flattened. Lower quality issues also outperformed higher quality bonds. Not surprisingly, the Prerefunded sector lagged other sectors given its shorter relative duration and high credit quality.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	April	YTD	Bloomberg Barclays Quality	April	YTD
Municipal Bond Index	0.38%	3.28%	AAA	0.26%	2.94%
General Obligation bonds	0.32%	3.11%	AA	0.35%	3.10%
Revenue bonds	0.43%	3.51%	A	0.44%	3.59%
Prerefunded bonds	0.00%	1.35%	BBB	0.52%	4.13%
Long maturities (22+ yrs.)	0.82%	4.70%	High Yield	0.56%	4.41%
Intermediate maturities (1 - 17 yrs.)	0.20%	2.72%	HY, ex-Puerto Rico	0.50%	4.00%
Short maturities (1 - 5 yrs.)	0.02%	1.35%			

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.