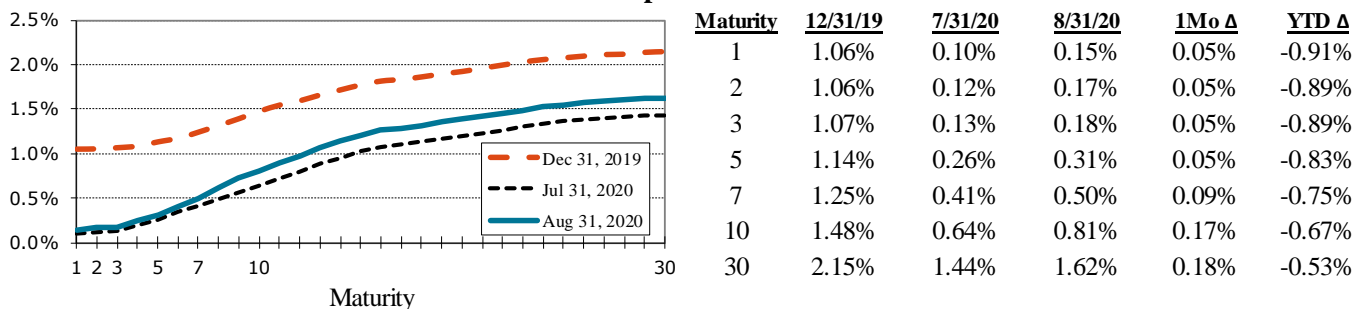


Baird Advisors
Municipal Fixed Income Market Commentary
August 2020

Curve Steepens as Yields Rise; Taxable Issuance Remains Elevated

The tax-exempt yield curve steepened last month as rates rose, although less so than Treasury yields at most points along the curve. Long-term tax-exempt yields rose 18 bps while short rates increased just 5 bps. Despite the higher rates, there was a solid tone in both the primary and secondary markets with relatively strong liquidity. A total of \$46B of new municipal supply came to market in August, 10% above the same month last year, boosting YTD supply to \$30B which is 29% ahead of last year's pace. According to Bloomberg, taxable municipals (including corporate cusips) represented 39% of August's issuance and an unprecedented 45% of total 2020 municipal volume. The ability for issuers to borrow at record low taxable rates with significant flexibility relative to the use of funds has been an attractive option for municipalities. Buyers have easily absorbed the brisk pace of taxable issuance, welcoming the diversification benefits that municipals offer. Even with the robust supply, taxable muni volume of \$139B YTD remains a fraction of total volume in the taxable markets where Treasuries/Agencies, corporates and mortgage-backed issues dominate. In contrast to the record taxable municipal issuance, tax-exempt supply is down 6% from last year's pace which has helped to mute municipal yield volatility. Inflows to tax-exempt funds were positive throughout August, extending the streak of positive weekly flows to sixteen; total inflows YTD are \$14B across the industry.

AAA Municipal Yields



Stalled Stimulus: Fed's MLF Offers Savings to the MTA

Market participants were disappointed that Republican and Democratic leaders were unable to reach agreement on additional fiscal stimulus in August. Due to the impasse, President Trump signed four executive orders as a partial, short-term fiscal solution. The orders: redirect money from FEMA to extend unemployment benefits, defer the 6.2% employee portion of the social security tax to December 31st, provide assistance for renters and homeowners, and allow for student loan deferrals through year end. Unfortunately, no direct fiscal support was provided for state and local governments and their funding needs remains a key differing point between the two sides. Some are looking at recent data on state tax revenues, which in many states are better than previously feared, and are unsure of the need for additional support. Others are looking beyond the improved recent data, believing additional funds will be needed to minimize the need for further layoffs and budget cuts, both of which will slow the economic recovery. Despite the lack of additional fiscal support, the Fed's Municipal Liquidity Facility (MLF) lent \$450M directly to the Metropolitan Transit Authority of NY at a below-market rate. The MTA realized a savings of 78 bps over where the public market was willing to lend (2.02% vs. 2.80%) for a term of three years. Also, the MLF lowered its interest rate for eligible municipalities by 50 bps over the Overnight Index Swap rate last month, but all-in costs of the MLF remain uneconomical for most municipalities.

Short Maturities and Lower Quality Outperform in August

Rising yields last month pushed returns into negative territory in all but the shortest maturities. This relative performance along the curve was also reflected in the outperformance of the Prerefunded sector, which has a much shorter average duration than the other market sectors. Credit spreads continued to recover from the sharp widening in March, leading to the outperformance of lower-rated credit categories last month. Positive YTD returns exist across nearly all segments/sectors of the market.

Total Returns of Selected Barclays Municipal Indices and Subsectors

<u>Bloomberg Barclays Index/Sector</u>	<u>August</u>	<u>YTD</u>	<u>Bloomberg Barclays Quality</u>	<u>August</u>	<u>YTD</u>
Municipal Bond Index	-0.47%	3.31%	AAA	-0.63%	4.20%
General Obligation bonds	-0.61%	3.99%	AA	-0.54%	3.66%
Revenue bonds	-0.44%	3.09%	A	-0.35%	2.83%
Prerefunded bonds	-0.13%	2.52%	BBB	-0.04%	1.14%
Long maturities (22+ yrs.)	-0.78%	3.28%	High Yield	0.26%	0.27%
Intermediate maturities (1 - 17 yrs.)	-0.33%	3.27%	HY, ex-Puerto Rico	0.36%	-0.44%
Short maturities (1 - 5 yrs.)	-0.01%	2.37%			

Disclosures

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.

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.