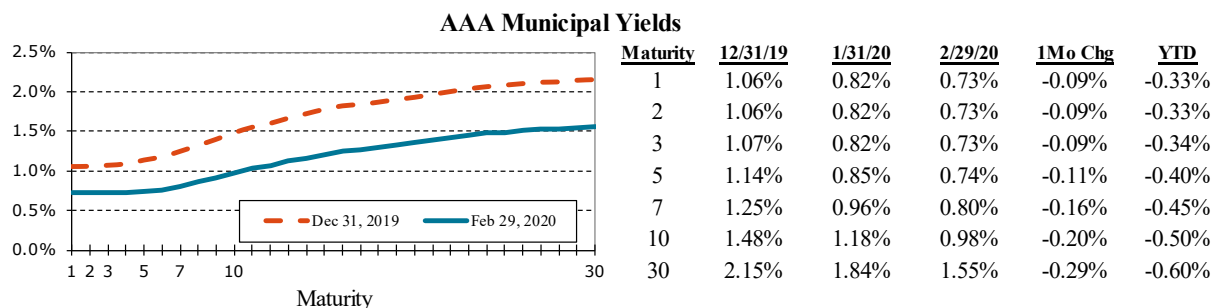


Baird Advisors
Municipal Fixed Income Market Commentary
February 2020

Tax-free Yields Fall on Spreading Coronavirus Concerns

Tax-free rates fell to record lows for maturities beyond 7 years in February as uncertainty over the economic impact of the coronavirus spread across the globe. What started as a China-focused virus had moved to every continent by month end despite aggressive attempts to quarantine the known cases. In the U.S. there were confirmed cases in seven states (and growing), according to the Centers for Disease Control and Prevention. Investor reaction to the spreading virus and growing uncertainty was swift and significant. The tax-free curve flattened as long-term rates fell more than short. One yield anomaly was a rise in cash equivalent rates as investors sold money markets to pay income taxes. The SIFMA rate, for example, which reflects weekly floating rate yields, rose 21 bps, from 0.94% to 1.15%, higher than the rate available on a 10yr AAA yield. Beyond the cash-equivalent segment, strong demand pushed all fixed-rate, tax-free yields lower last month. The streak of positive consecutive weekly flows into municipal bond mutual funds continued, already receiving \$28.4B of new flows in 2020, well ahead of last year's record pace. Helping this was the rise of Bernie Sanders in the Democratic Presidential nomination process, given his focus on raising tax rates on the wealthy. Municipals also benefited as a safe haven from global concerns given the domestic orientation of their tax revenues. Municipal credit spreads narrowed in February, unlike the widening that occurred among taxable corporate spreads. From a supply perspective, issuance rose last month. Tax-exempt gross volume is up 13% YoY, but the bigger story is the dramatic increase in taxable municipal volume; YTD taxable volume running nearly 2.5X last year's pace.



Municipal Credit Updates

- A \$5.4B Buckeye Ohio Tobacco issue, the largest municipal deal since 2009, came to mark in February. It refinanced a 2007 issue that was likely to default within four years if cigarette consumption declines remain on pace. This issue lowers borrowing costs for the issuer and extends the repayment time frame, strengthening the credit quality. It was well received by the market as over 100 different institutional investors participated. Ohio is just one of 21 states that have securitized the revenues provided by a 1998 master settlement agreement between the tobacco companies and state attorneys general to help cover health care costs related to smoking.
- Illinois' Governor Pritzker released his fiscal year 2021 budget plan to broad acceptance by the rating agencies. While the budget provides \$9B to meet the actuarially required annual pension payment it offers no long-term plan of pension reform, nor does it address the \$6B backlog of unpaid bills. The plan sets aside \$1.4B of payments for education and local government payments, but is contingent on the passage of a progressive income tax structure in November.

Municipal Rate Rally Boosts YTD Returns

February built on the strong returns in January, providing a second month of surprisingly strong results for investors as municipal rates fell and credit spreads narrowed. Risk-on strategies were once again rewarded as longer maturities outperformed short-term issues and lower quality issues outperformed higher quality debt. The returns of the BBB category (2.02%) and municipal High Yield issues (2.11%) easily exceeded the return on AAA rated issues (1.12%).

Total Returns of Selected Barclays Municipal Indices and Subsectors

<u>Bloomberg Barclays Index/Sector</u>	<u>February</u>	<u>YTD</u>	<u>Bloomberg Barclays Quality</u>	<u>February</u>	<u>YTD</u>
Municipal Bond Index	1.29%	3.11%	AAA	1.12%	2.83%
General Obligation bonds	1.22%	3.02%	AA	1.17%	2.90%
Revenue bonds	1.39%	3.32%	A	1.39%	3.27%
Prerefunded bonds	0.32%	0.96%	BBB	2.02%	4.37%
Long maturities (22+ yrs.)	2.15%	4.63%	High Yield	2.11%	4.62%
Intermediate maturities (1 - 17 yrs.)	0.95%	2.49%	HY, ex-Puerto Rico	2.08%	4.10%
Short maturities (1 - 5 yrs.)	0.35%	1.03%			

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.