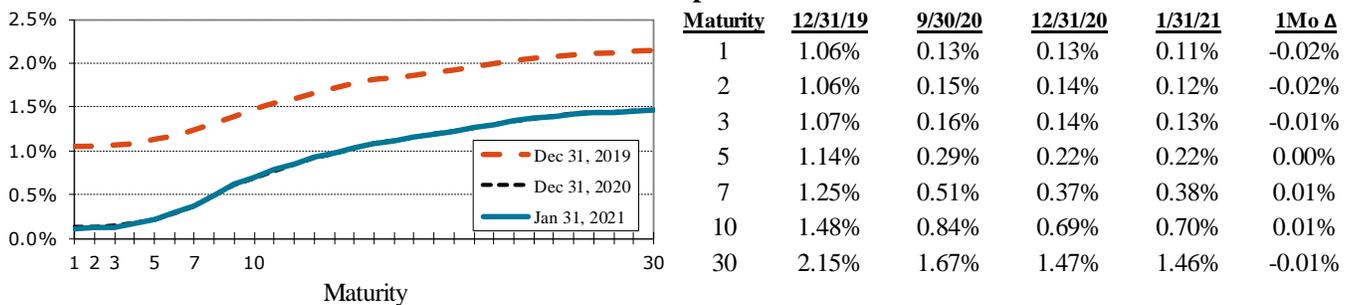


Baird Advisors
Municipal Fixed Income Market Commentary
January 2021

Strong Rally in Lower-Rated Municipals, Democrats Take Control in Washington DC

Municipal AAA yields were largely unchanged across the yield curve in January while lower-quality credits handily outperformed. BBB rates fell 31 bps, for example, as strong demand for additional yield was buoyed by hopes of a strong economic recovery, additional fiscal stimulus and very favorable supply/demand technicals. Total issuance fell 18% YoY in January to \$31B with roughly one-third issued as taxable municipals, leaving tax-exempt supply even more scarce. January's light issuance put the market well off last year's full-year pace of \$500B in total supply and below expectations of achieving a similar total in 2021 as well. Investor demand was robust with nearly \$14B of inflows to funds, which is ahead of the pace from January 2020. Short maturity and high yield funds garnered the most inflows when viewed as a percentage of assets in their respective fund categories. This favorable market backdrop led tax-exempt municipals to outperform most other U.S. fixed income markets in January. Investors also closely watched as the election season officially ended with Democrats sweeping the Senate runoff elections in Georgia and the transition of power to President Biden. With Democrats now in control at the federal level, a proposed \$1.9T of fiscal stimulus is the primary focus, while key Republicans have offered support for a smaller, more targeted package. If middle ground on stimulus cannot be found, the partisan budget reconciliation process is a possible path for at least part of the fiscal agenda the Democrats seek. Although not yet clear whether changes to tax policy and an infrastructure plan will be taken up this year, each will be closely monitored for the potential impact they could have on municipal supply and demand in 2021.

AAA Municipal Yields



Vaccinations and Reopening Become Visible

Vaccinations continue to be administered across the country with a focus on healthcare workers and older Americans first. Fortunately, many regions are seeing case counts and virus-related hospitalizations on the decline. 2020 underscored the essentiality of the U.S. hospital system, which demonstrated the ability to pivot from elective procedures to Covid-19 treatment. Many thrived with the help of various Federal aid packages to offset the fiscal challenges. Despite steep declines in March and April 2020, hospital revenues rose for the full calendar year compared to 2019 and liquidity measures also strengthened. Past investments by hospitals in electronic record systems bore fruit and improved healthcare delivery. Telehealth, long a goal for convenience and cost-saving benefits, became the norm and is likely here to stay. Like the Hospital sector, the fiscal health of state and local governments also withstood the economic disruptions in 2020 quite well. For the 47 states that have reported their 2020 annual revenues, the average YoY decline was just 0.12%. One interesting finding among the data was that states with a progressive tax structure benefited from the fact that higher-income taxpayers were less impacted by Covid-19 job losses, in some cases experiencing YoY revenue increases. For example, California's controller reported tax collections of over \$91B for the second half of 2020, which was 25% ahead of budget and an amazing 47% above the same six-month period in 2019.

Positive January Returns Driven by Lower-Rated and Longer-Dated Securities

Municipals outperformed the taxable market in January, driven by risk-seeking investors in longer maturities and lower-rated issues. Lower-rated credit outperformed higher-rated due to the additional income they provided and price appreciation as credit spreads tightened. As expected in such an environment, Revenue bonds outperformed GOs and Prerefunded bonds.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

<u>Bloomberg Barclays Index/Sector</u>	<u>2020</u>	<u>January</u>	<u>Bloomberg Barclays Quality</u>	<u>2020</u>	<u>January</u>
Municipal Bond Index	5.21%	0.64%	AAA	5.51%	0.31%
General Obligation bonds	5.49%	0.54%	AA	5.24%	0.43%
Revenue bonds	5.31%	0.72%	A	5.27%	0.88%
Prerefunded bonds	2.76%	0.17%	BBB	4.55%	1.78%
Long maturities (22+ yrs.)	6.25%	0.98%	High Yield	4.89%	2.09%
Intermediate maturities (1 - 17 yrs.)	4.73%	0.48%	HY, ex-Puerto Rico	4.02%	2.04%
Short maturities (1 - 5 yrs.)	2.83%	0.23%			

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.

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