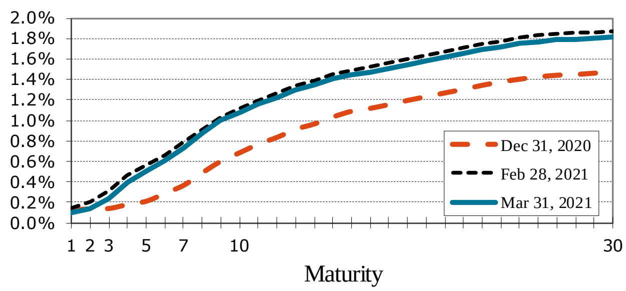
Baird Advisors
Municipal Fixed Income Market Commentary
March 2021

Municipal Curve Steepens on Growth/Inflation Concerns

Tax-exempt yields rose this quarter in all but the shortest maturities, steepening the curve on strong economic growth and rising inflation concerns. Short yields fell 3 bps while intermediate and long rates rose nearly 40 bps. Yet, relative to Treasury yields which rose nearly twice as much, municipal volatility was quite muted leading to strong relative performance. In fact, tax-free performance relative to taxable in Q1 was the fifth best quarter of outperformance since 1981, according to Bloomberg Barclays data. Fueling this was an expectation for higher taxes and an improving economy and municipal credit backdrop. Passage of the American Rescue Plan Act (ARPA), which provides $1.9 trillion in fiscal support, including strong direct support for municipalities (see below), boosted investor demand, particularly for lower-quality credits which significantly outperformed higher-quality issues this quarter. Impressively, the outperformance of municipals occurred even as total municipal supply rose 15% YoY, including an 18% increase in tax-exempt supply and a 9% increase in taxable municipal issuance. Taxable municipal supply comprised 28% of Q1 issuance, significant but less than the 36% share it represented for all of 2020. Still, investor demand more than offset the boost in supply. Net inflows to municipal funds in Q1 of $31.7B was the best first-quarter flow ever recorded.

AAA Municipal Yields



Maturity	12/31/19	12/31/20	2/28/21	3/31/21	1Mo Δ	YTD Δ
1	1.06%	0.13%	0.14%	0.10%	-0.04%	-0.03%
2	1.06%	0.14%	0.21%	0.14%	-0.07%	0.00%
3	1.07%	0.14%	0.31%	0.24%	-0.07%	0.10%
5	1.14%	0.22%	0.57%	0.50%	-0.07%	0.28%
7	1.25%	0.37%	0.78%	0.73%	-0.05%	0.36%
10	1.48%	0.69%	1.12%	1.08%	-0.04%	0.39%
30	2.15%	1.47%	1.87%	1.81%	-0.06%	0.34%

ARPA, AJP, AFP and Taxes

In addition to the recently passed American Rescue Plan Act (ARPA), with an estimated $668B of the $1.9 trillion in total fiscal stimulus going to state/local governments and other municipal entities, President Biden also outlined the first phase of his two-part *Build Back Better* infrastructure plan. Phase one is the American Jobs Plan (AJP), an ambitious $2.25 trillion proposal with: **$650B of quality-of-life enhancements** (public housing, high-speed broadband, public schools, the electric grid, clean drinking water, et al), **$620B for transportation** (electric vehicles, roads, bridges, public transit, rail and airports), **$580B for manufacturing** (domestic, including small manufacturers and clean energy), and **$400B for elderly and disabled care**. The spending would occur over eight years and the cost would be partially offset by higher corporate taxes. The second phase, which will be further outlined in a few weeks, is the American Families Plan (AFP), which will be targeted toward social concerns, such as expanding healthcare, free community college and universal Pre-K programs. The cost of this second phase is expected to be borne by tax increases on higher-income individuals. Like the process for passage of the ARPA, with bipartisan support unlikely, the two-phase infrastructure plans may need to be combined and reduced in scope to qualify for passage through the budget reconciliation process, which requires just a 51-vote majority in the Senate. Markets will be closely following the political process in the coming months, but from what we already know from the ARPA, and what we anticipate may happen under the *Build Back Better* push, there are many positive developments unfolding for municipalities and municipal investors alike.

Solid March Returns Provide Mixed Returns for the Quarter

Lower-quality credits set the pace both in March and the full quarter as spreads narrowed; investors demonstrated a willingness (desire) to accept greater credit risk given the massive fiscal stimulus for municipalities. High Yield was the winner in March and YTD while AAA issues lagged in both periods. Longer maturities outperformed other curve segments last month, but shorter maturities outperformed for the full quarter. The strong demand for lower-quality credits and yield declines in March provided positive returns across all market sectors last month and only modestly negative returns beyond short maturities for the quarter.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	March	YTD	Bloomberg Barclays Quality	March	YTD
Municipal Bond Index	0.62%	-0.35%	AAA	0.52%	-0.90%
General Obligation bonds	0.63%	-0.54%	AA	0.58%	-0.65%
Revenue bonds	0.65%	-0.29%	A	0.66%	0.06%
Prerefunded bonds	0.13%	-0.12%	BBB	0.90%	1.28%
Long maturities (22+ yrs.)	1.00%	-0.47%	High Yield	1.08%	2.11%
Intermediate maturities (1 - 17 yrs.)	0.47%	-0.32%	HY, ex-Puerto Rico	1.16%	2.35%
Short maturities (1 - 5 yrs.)	0.24%	0.08%			

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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