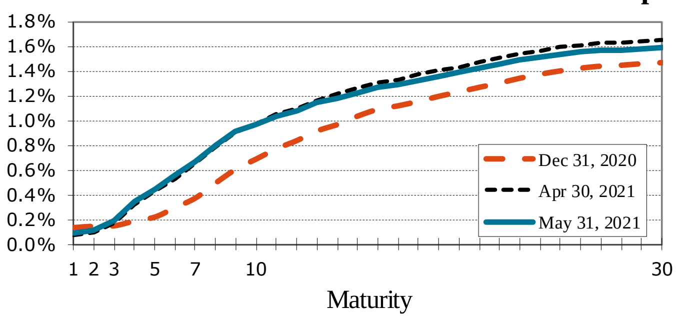
Baird Advisors
Municipal Fixed Income Market Commentary
May 2021

Light Supply and Positive Demand Support Prices

Municipal yields were little changed in May other than the longest maturities where yields fell 6 bps, leading to a slightly flatter curve. Issuance fell MoM, to $34B from $40B in April, but is 22% ahead of last year's pace. All the increased supply this year has been tax-exempt as taxable issuance is unchanged YoY, although an impressive 28% of the 2021 total. Putting the YTD tax-exempt supply in the context of a longer timeframe illustrates the lack of growth in the municipal market since the Great Recession of 2008-09. While up on a YoY basis, total tax-exempt supply YTD of $133B is only marginally higher than the average YTD issuance of $123B going back to 2010. In contrast, both corporate and Treasury issuance have grown substantially over the last decade. Unfortunately, until agreement on a federal infrastructure package is reached, we are unlikely to see any meaningful increase in municipal supply. Demand, on the other hand, from maturing or called debt plus new inflows continues to grow, especially for tax-exempts, and has more than offset YTD supply. Even with modest slowing of inflows mid-month, likely due to tax-payment needs, municipal funds still received $6.5B of new inflows in May, bringing YTD net inflows to $48B. Demand has been particularly strong for long-dated and high yield funds as the need for additional income in a low rate environment continues. The persistent and growing demand from aging baby boomers, who are seeking a safe, tax-sheltered income source, is likely to continue for years and any increase in rates will likely fuel even more demand as stated in a recent Baird Advisors white paper.

AAA Municipal Yields



Maturity	12/31/20	4/30/21	5/31/21	1Mo Δ	YTD Δ
1	0.13%	0.08%	0.09%	0.01%	-0.04%
2	0.14%	0.10%	0.11%	0.01%	-0.03%
3	0.14%	0.17%	0.19%	0.02%	0.05%
5	0.22%	0.43%	0.45%	0.02%	0.23%
7	0.37%	0.65%	0.66%	0.01%	0.29%
10	0.69%	0.98%	0.97%	-0.01%	0.28%
30	1.47%	1.65%	1.59%	-0.06%	0.12%

Infrastructure Negotiations Continue, State/Local Aid Distributions Begin to Enhance Recovery

Negotiations to reach bipartisan agreement on infrastructure continue, but it looks increasingly likely the Democrats may go it alone through budget reconciliation. President Biden lowered his original $2.25 trillion goal of the American Jobs Plan to $1.7 trillion, with the costs offset by a series of corporate tax increases, while Senate Republicans countered with a revised $928B plan, paid for by funds already allocated by Congress, demonstrating that the two sides remain far apart. State and local fiscal health remains on sound footing as distributions of the $350B from the American Rescue Plan Act began in May. For many states, where their unemployment rate is less than 2% above the rate on February 2020, and for all local governments, the aid will be distributed in two equal phases, now and up to 12 months later. The remaining states will receive a single, lump sum distribution now. A Treasury Department press release this month revealed the motivation to provide significant fiscal stimulus to municipalities. Treasury Secretary Janet Yellen stated that "*the federal government didn't provide enough aid to close the gap* (after the Great Recession). *That was an error. Insufficient relief meant that cities had to slash spending, and that austerity undermined the broader recovery*." While the economic rebound has been strong since the depths of the pandemic, state and local government employment remains 1.2 million jobs below the pre-Covid peak, according to the U.S. Bureau of Labor Statistics.

Lower Quality Municipals Continue Their Trend of Outperformance

Positive returns in May added to the favorable YTD results. Longer maturities outperformed short and intermediate segments of the curve this month and lower quality outperformed higher-rated issues. For context, AAA-rated municipals outperformed BBBs by 0.96% for the calendar year 2020. Conversely, BBB-rated municipals have outperformed AAA by 3.29% YTD. Revenue bonds, which carry lower ratings on average, outperformed General Obligation and Prerefunded municipals in May.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	May	YTD	Bloomberg Barclays Quality	May	YTD
Municipal Bond Index	0.30%	0.78%	AAA	0.11%	-0.06%
General Obligation bonds	0.17%	0.36%	AA	0.25%	0.34%
Revenue bonds	0.38%	1.03%	A	0.39%	1.39%
Prerefunded bonds	0.00%	0.04%	BBB	0.65%	3.23%
Long maturities (22+ yrs.)	0.71%	1.63%	High Yield	1.15%	4.80%
Intermediate maturities (1 - 17 yrs.)	0.14%	0.44%	HY, ex-Puerto Rico	1.10%	4.95%
Short maturities (1 - 5 yrs.)	0.02%	0.33%			

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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