Treasury yields fall significantly on a) Fed rate cut, b) trade tariff extension on Chinese imports and c) Chinese currency and agricultural import restrictions counterpunch

Muni yields slightly lower. Taking note of lowest ratio ever in 1-yr space.

Muni fund see inflows – 30th consecutive week. Most inflows for even a full year since 2009.

Puerto Rico swears in new governor.

S&P Puerto Rico Total Return Index was +0.7% last week (+10.2% YTD).

What Happened in the Bond Markets Last Week?

Treasuries had a positive week. Leading up to the FOMC rate decision on Wednesday yields were locked into a tight range. Upon the announcement of the rate cut (which was completely expected), the Fed indicated that they did not continue rate cuts as a matter of a new rate-cutting cycle, rather the cut should be viewed as an insurance cut and future cuts would be predicated on data. On Thursday, with the surprise announcement of further trade tariffs on Chinese imports, yields fell significantly through Friday on the expectation of continuing global economic slowing. And then over the weekend, China weakened the Yuan and announced the restricted US agricultural imports. People will be looking for the off-ramp to the escalation of the trade war.

Municipal bonds’ yields also fell sharply.

Yields (Figure 1):

- During the past week ending 7/19, Treasury yields fell materially; 2-year Treasury Note yields -25.5 bps to 1.61%, 5-year Notes yields -29.1 bps to 1.56%, 10-year Notes yields -31.2 bps to 1.76% and 30-year bonds yields -28.8 bps at 2.30%.
- Bloomberg Municipal Index curve yields also fell sharply; AAA-rated GO yields 2-year bonds -7 bps to 1.05%, 5-year bonds -8 bps at 1.10%, 10-year bond yields -10 bps to 1.44% and 30-year bonds unchanged at -10 bps at 2.25%.
- The 10yr AAA GO Ratio ended at 78.6.
One can observe these changes by looking at how rates have changed along the curve for both the Treasury curve and for the AAA-rated G.O. Index since last week. The top panel shows four yield curves; two for the Treasury curve - one for the most current date and one from last week and two for the AAA-rated G.O. - current and last week. The bottom panel of the graph shows changes in the rates along both curves for the week for both Treasuries and the AAA G.O. Index.
Supply (Figure 3) – Bloomberg 30-Day Visible Supply currently stands at $17.0 billion up from $13.1 billion this time last week. The YTD average visible supply is $9.5 billion and the 12-mo average is $9.3 billion.
Articles of Interest

**Muni Fund Flows:** According to Refinitiv Lipper muni funds had a 30th consecutive week of net inflows. Net inflows amounted to $433.6 million of net inflows. The four-week moving average is $1.3 billion. Both ETFs and high-yield funds experienced net inflows.

![Lipper: Muni funds see inflows](image)

**One-year Munis Most Expensive Ever (Bloomberg Brief):** Municipal bonds with maturities less than one year have rallied so much that they are now at their most expensive level ever according to Bloomberg data. The yield on 1 yr AAA GO bonds at 1.1% hit a ratio to Treasuries of 55%. According to Vikram Rai of Citigroup, “Because many people have higher effective tax rates, many clients just don’t want to bother with the sale of the muni securities.” Also, 5-yr ratios fell to the lowest level (64%) since 2010.

**Puerto Rico**
- **The S&P Municipal Bond Puerto Rico Index** finished at 196.6 on Friday vs. 195.2 at the end of the previous week, +0.7% (+10.2% YTD).
- **Puerto Rico Has a New Governor:** Puerto Rico swore in a new governor after former Governor Rosello resigned amidst controversy.
Relative Value by Maturity

Table 1 - AAA Muni Ratios and Spreads by Maturity - Data Source: Bloomberg

<table>
<thead>
<tr>
<th>Maturity (yrs.)</th>
<th>Yield-to-worst (%)</th>
<th>Spread (bps)</th>
<th>Ratio (%)</th>
<th>Spread (bps)</th>
<th>Ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>8/5/2019</td>
<td>AAA Gen. Oblig.</td>
<td>Treasury</td>
<td>0% Tax Rate</td>
<td>35% Tax Equivalent</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>1.04</td>
<td>1.76</td>
<td>-72.6</td>
<td>58.8</td>
<td>-16.7</td>
</tr>
<tr>
<td>2</td>
<td>1.05</td>
<td>1.62</td>
<td>-57.0</td>
<td>64.9</td>
<td>-0.3</td>
</tr>
<tr>
<td>3</td>
<td>1.06</td>
<td>1.58</td>
<td>-52.1</td>
<td>67.1</td>
<td>5.0</td>
</tr>
<tr>
<td>4</td>
<td>1.07</td>
<td>1.58</td>
<td>-50.9</td>
<td>67.8</td>
<td>6.9</td>
</tr>
<tr>
<td>5</td>
<td>1.10</td>
<td>1.58</td>
<td>-47.9</td>
<td>69.7</td>
<td>11.4</td>
</tr>
<tr>
<td>7</td>
<td>1.23</td>
<td>1.67</td>
<td>-43.6</td>
<td>73.8</td>
<td>22.7</td>
</tr>
<tr>
<td>10</td>
<td>1.45</td>
<td>1.77</td>
<td>-32.3</td>
<td>81.8</td>
<td>45.7</td>
</tr>
<tr>
<td>15</td>
<td>1.81</td>
<td>1.96</td>
<td>-14.6</td>
<td>92.5</td>
<td>83.1</td>
</tr>
<tr>
<td>20</td>
<td>2.00</td>
<td>2.08</td>
<td>-8.0</td>
<td>96.1</td>
<td>99.4</td>
</tr>
<tr>
<td>25</td>
<td>2.19</td>
<td>2.19</td>
<td>-0.7</td>
<td>99.7</td>
<td>117.0</td>
</tr>
<tr>
<td>30</td>
<td>2.25</td>
<td>2.31</td>
<td>-6.1</td>
<td>97.4</td>
<td>115.2</td>
</tr>
</tbody>
</table>
Relative Value by Rating

For more information please contact your Financial Advisor.
Appendix – Important Disclosures

Some of the potential risks associated with fixed income investments include call risk, reinvestment risk, default risk and inflation risk. Additionally, it is important that an investor is familiar with the inverse relationship between a bond’s price and its yield. Bond prices will fall as interest rates rise and vice versa.

When considering a potential investment, investors should compare the credit qualities of available bond issues before they invest. The two most recognized rating agencies that assign credit ratings to bond issuers are Moody's Investors Service (“Moody’s”) and Standard & Poor's Corporation (“S&P”). Moody’s lowest investment-grade rating for a bond is Baa3 and S&P’s lowest investment-grade rating for a bond is BBB-. Ratings are measured on a scale that ranges from AAA or Aaa (highest) to D or C (lowest).

The Bond Buyer 20-Bond Index consists of 20 general obligation bonds that mature in 20 years. The average rating of the 20 bonds is roughly equivalent to Moody's Investors Service's Aa2 rating and Standard & Poor's Corp.'s AA. The Bond Buyer 11-Bond Index uses a select group of 11 bonds in the 20-Bond Index. The average rating of the 11 bonds is roughly equivalent to Moody’s Aa1 and S&P's AA-plus. The Bond Buyer Revenue Bond Index consists of 25 various revenue bonds that mature in 30 years. The average rating is roughly equivalent to Moody's A1 and S&P's A-plus. The indexes represent theoretical yields rather than actual price or yield quotations. Municipal bond traders are asked to estimate what a current -coupon bond for each issuer in the indexes would yield if the bond was sold at par value. The indexes are simple averages of the average estimated yields of the bonds, are unmanaged and a direct investment cannot be made in them.

This is not a complete analysis of every material fact regarding any sector, municipality or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy. 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. It is strongly recommended that an investor discuss with their financial professional all materially important information such as risks, ratings and tax implications prior to making an investment. Past performance is not a guarantee of future results.

This report does not provide recipients with information or advice that is sufficient on which to base an investment decision. This report does not take into account the specific investment objectives, financial situation, or need of any particular client and may not be suitable for all types of investors. Recipients should consider the contents of this report as a single factor in making an investment decision. Additional fundamental and other analyses would be required to make an investment decision about any individual security identified in this report.

ADDITIONAL INFORMATION ON SECURITIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST BY CONTACTING YOUR BAIRD INVESTMENT PROFESSIONAL.