CITYWIRE PROFESSIONAL BUYER

ISSUE 72 ■ APRIL 2020 ■ CITYWIREUSA.COM
FOR PROFESSIONAL BUYERS

LYLE FITTERER & DUANE MCALLISTER

Even munis have been caught up in the coronavirus crash, but Baird Advisors' muni bond co-heads can see the light at the end of the tunnel

NICOLE PIPER

You know things are bad when muni managers start to worry.

Historically regarded as something of a safe haven, even these most 'boring' of bonds have been caught up in the market crash, triggered by the outbreak of the coronavirus.

'We've never really had anything quite like this in the past,' Duane McAllister says. 'In a way, we've been thinking about this as sort of a natural disaster. No city brought this upon themselves, and the market didn't do anything wrong. It just happened. It's an exogenous event.'

McAllister is co-head of municipal bonds at Baird Advisors alongside Lyle Fitterer. Despite the typically slow and steady nature of their speciality, the two managers find themselves in unchartered territory.

While stocks and riskier areas of the fixed income market, such as credit and high yield, suffered first and worst as markets fell on fears of the coronavirus, no asset class proved truly safe, and munis were also hit as investors dashed to cash. Investors wanted their assets liquid and were concerned that the costs of coping with Covid-19 might impact governments' abilities to repay debt.

Redemptions led to liquidity concerns while the cost of borrowing for states and cities skyrocketed. This pushed the Federal Reserve to expand its plans to support the Treasury and agency mortgage-backed security market, and also buy short-term munis.

'From our perspective, as fund managers, our primary focus is just making sure there's enough liquidity in the funds as we're starting to see redemptions begin,' McAllister says. 'It starts with knowing how much liquidity you have every single morning, but then also anticipating where you might need to find liquidity over the next several days.'

> WE'VE NEVER REALLY HAD ANYTHING QUITE LIKE THIS IN THE PAST
>
> **DUANE MCALLISTER**

It has been a while since muni managers have had to worry about outflows at all, let alone those this significant. The Morningstar muni bond category had seen net inflows in every month of 2019 and began 2020 taking in $14.1bn in January, a record month. Even in February, as the selloff began, muni funds took in $10.8bn. Not so much in March. According to Lipper, in the week ending March 18, investors pulled $12.2bn from muni funds, having withdrawn $1.76bn the previous week.

Fitterer says he is cautiously optimistic the Fed's intervention will help issuers and, eventually, the market. But the managers recognize that the Fed can only do so much, and the pandemic is out of their hands.

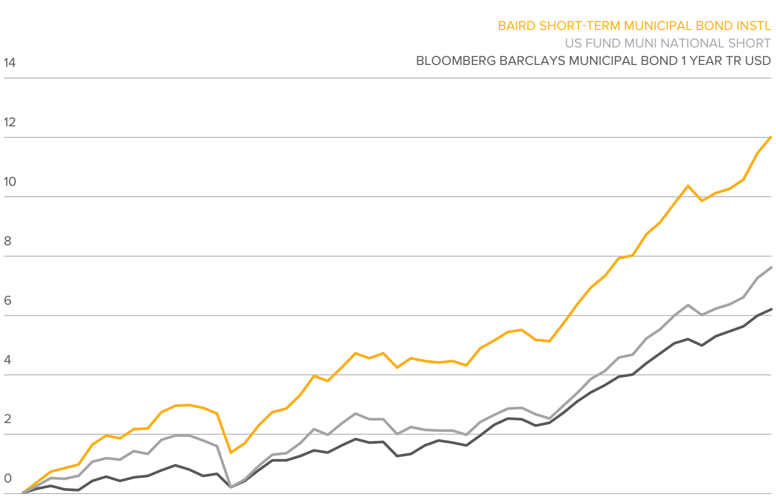
'I think it's very likely that this will be volatile for some time, and that could be several weeks or could be a few months,' McAllister says. 'But this is not a long-term credit event. At the same time, we're saying, "to the extent you've got any extra cash on the sidelines that isn't targeted for equities or something else, now is a great time to at least be looking at the muni market and considering that as one of your investment options,"' he adds.

BACK TOGETHER

Fitterer and McAllister manage the $995.3m Baird Short-Term Municipal Bond fund alongside co-managers Joe

THE BAIRD SHORT-TERM MUNICIPAL BOND FUND IS AHEAD OF ITS PEERS AND THE INDEX SINCE LAUNCH

SOURCE: MORNINGSTAR & EIKON / DATA TO FEBRUARY 29, 2020



Czechowicz and Erik Schleicher.

McAllister, Czechowicz and Schleicher have managed the fund since its inception in 2015, but Fitterer is a relative newcomer to the group. He made headlines last July when he stepped down as Wells Fargo Asset Management's co-head of fixed income and moved to Baird to work alongside McAllister, who advocated vociferously for his former boss.

McAllister was paying it forward. Fitterer says that a few years ago, he recommended McAllister during a flight with Jay Schwister, research director and senior portfolio manager of Baird's fixed income team.

'Ironically, I'm probably here because of Lyle and Lyle's, and probably partly here because of me,' McAllister says.

To these two, the pairing seemed as natural as can be. They had worked together from 2002 to 2004 at Strong Funds, which Wells Fargo acquired in 2004. They have a natural rapport and work ethic that made for an easy transition.

'I don't want to get hokey here, but I grew up on a farm, and Duane grew up working for his dad, who was in construction. I think that background builds a certain type of character that has helped us work really well together,' Fitterer says.

THE MUNI GUYS

Both managers didn't exactly dream of managing municipal bond funds, but they both agree they've found their niche.

'I've yet to meet a muni manager who goes to school or grows up saying: "Gosh, I want to grow up and be a muni manager,"' says McAllister, who initially wanted to manage taxable bond funds.

McAllister joined Baird in 2015, and before that, he spent seven years as a portfolio manager for BMO Asset Management by way of MNI, which BMO acquired in 2010.

'It actually suits me better,' he admits of non-taxable bond management. 'It's been 30 years, I guess, of municipal management all across the yield curve, from short to intermediate to long, but almost entirely focused on the investment-grade part of the curve,' he says.

Fitterer, meanwhile, cut his teeth as a mutual fund accountant and later became an equity trader before finding his groove with munis. Like McAllister, he also initially scoffed at the non-taxable side of the bond industry.

'We used to laugh at the muni guys, in terms of how different the market was, how slow the market reacted, and really just how the market generally functioned,' he says. 'We laughed about, gee, who would want to be a muni guy?'

Fast forward to 2000, when Fitterer became THE muni guy, leading the municipal bond team at Strong Funds. Two years after that, the head of the company, Dick Strong, tapped McAllister to join the team, reporting to Fitterer.

'What told me a lot about Lyle right from the get-go was that I was thrown into his group, even without them necessarily needing a person, but he more than welcomed me. We became close working together, sitting side by side,' McAllister says.

Two years after that, when Wells Fargo acquired Strong Funds, McAllister made the decision to move on.

'We just had probably too many resources for the amount of assets that we had at that point,' Fitterer says. 'Unfortunately, Duane made the decision that he would hop out and go do something else because I think his feeling was that there just wasn't enough for everybody to do. It was unfortunate because I think we had a great working relationship, but I respected him for that.'

After Wells completed the acquisition of Strong in 2005, Fitterer stayed with the firm for another 15 years before deciding to move on.

'I'd been there 30 years. That, plus my age, made me eligible for retirement. I was really looking at what I wanted to do for the rest of my career, and I wasn't sure at that point,' he says.

Fitterer didn't have to wait long before Baird came calling with an offer: join the team and help co-manage munis with his old co-worker, McAllister. He joined in what Fitterer describes as an almost-seamless transition.

'I think part of the reason why I knew that this would work was because the approach was very similar to the way that I managed money at Wells and the way that Duane and I managed money together as well,' Fitterer says.

STAYING IN THE GAME

As the name suggests, the team's flagship short-term municipal bond fund targets bonds with a short-term maturity, investing in the one-to-five-year segment of the yield curve. It has an expense ratio of 0.3% for institutional shares and 0.55% for investor shares, and its allocations closely mirror the Bloomberg Barclays 1-5 Year Short Municipal Bond index.

'We're very much benchmark-aware and focused on it as a way to control risk,' McAllister says. 'We should always achieve benchmark-like returns if we do nothing else.'

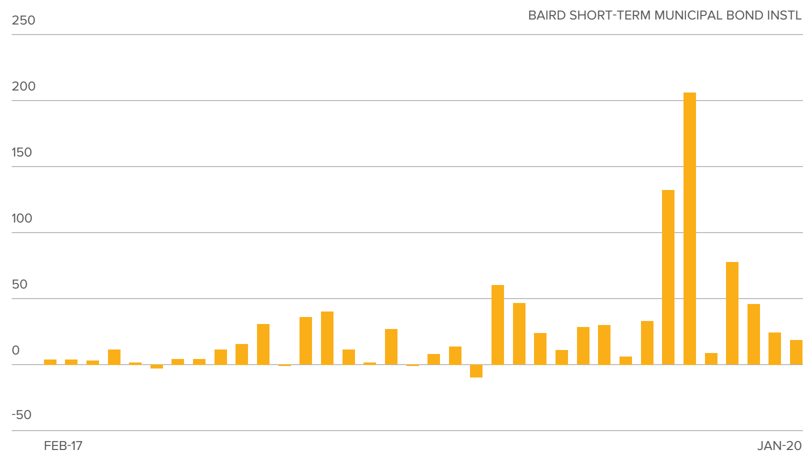
Another way the managers control risk is by maintaining a duration-neutral approach to portfolio management, a strategy that Baird has been using since before they joined the firm.

'They were doing that back in the early 80s, and they thought they were having success with it by aligning the duration and making other strategic decisions relative to that,' McAllister adds. 'Really more as a means of risk control, rather than alpha generation – it's just keeping you in the game.'

They have begun to take measures to prepare the portfolio for the new normal, cutting some exposure to airports.

THE FUND HAD INFLOWS FOR MORE THAN A YEAR BEFORE THE MARKET CRASH

SOURCE: MORNINGSTAR / DATA TO FEBRUARY 29, 2020



> WE USED TO LAUGH AT THE MUNI GUYS, IN TERMS OF HOW SLOW THE MARKET REACTED
> **LYLE FITTERER**

'We had three smaller positions, and we sold them out of the portfolio. Being in the business long enough, and especially when you're in an environment where you're not getting paid a large amount of incremental income to be in certain sectors, when you run into a situation like this, I think it's a pretty easy decision to say: "Let's just take some chips off the table, and then we'll revisit it once we have a better understanding of what the impact is going to be,"' McAllister says.

While they admit municipal bonds are generally not considered overly opportunistic, the managers are closely watching out for different municipalities to respond to the virus.

'Chicago will handle this differently than Seattle did it, New York might be different, Milwaukee would be different, but individually, each of these communities will figure it out,' McAllister says.

Despite all this, the two managers are looking ahead, and McAllister says the fund is prepared to weather the economic storm.

'When a natural disaster occurs, it's an exogenous event, it impacts the economy, activity stops, sometimes lives are lost, and then what you do? Each municipality assesses the risks and the damage, and eventually, resources are gathered to help stabilize the situation,' he says. 'And you begin to rebuild and life – sometimes quickly, sometimes gradually – comes back to normal.' ■

Important Disclosure Information

The statements and opinions expressed here are current as of the date of the interview and are subject to change. The opinions of the author are not necessarily those of Baird. This is not a complete analysis of ever material fact that should be considered when making an investment decision.

Investors should consider the investment objectives, risks, charges and expenses of each fund carefully before investing. This and other information is found in the prospectus and summary prospectus. For a prospectus or summary prospectus, contact Baird directly at 866-442-2473. Please read the prospectus or summary prospectus carefully before investing.

Performance data represents past performance and does not guarantee future results. The investment return and principal value of the investment will fluctuate so that shares, when redeemed, may be worth more or less than their original cost. Current performance data may be lower or higher than the data quoted. For performance data to the most recent month end, contact Baird directly or go to our website bairdfunds.com.

Performance as of March 31, 2020:

	Expenses (Gross/Net)	**QTD**	**1 Year**	**3 Years**	**Since Inception**
Baird Short-Term Municipal Bond Fund (Inst Class)	0.30/0.30	-0.39%	2.07%	2.32%	2.13%
Bloomberg Barclays 1-5 Year Short Municipal Bond Index		-0.41%	1.88%	1.79%	1.54%

Inception date: 8/31/2015

Because the Fund may invest more than 25% of its total assets in municipal obligations issued by entities located in the same state or the interest on which is paid solely from revenues of similar projects, changes in economic, business or political conditions relating to a particular state or types of projects may have a disproportionate impact on the Fund. A bond's market value may be affected significantly by changes in interest rates – generally, when interest rates rise, the bond's market value declines and when interest rates decline, its market value rises ("interest rate risk").

All investments carry some level of risk, including loss of principal and diversification does not ensure a profit or protect against loss. 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 risk such as interest rate risk, regulatory risk, credit risk, inflation risk, call risk, default risk, political risk, tax policy 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. Municipal securities investments are not appropriate for all investors, especially those taxed at lower rates.

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.

Total Fund AUM as of March 31, 2020, for both the Institutional and Investor share classes were $1.01B.

Baird Funds are offered through Robert W. Baird & Co. Incorporated, a registered broker/dealer, member NYSE and SIPC. Robert W. Baird & Co. also serves as investment advisor for the Fund and receives compensation for these services as disclosed in the current prospectus.