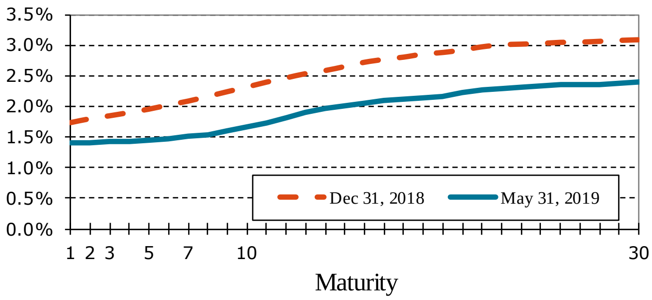
Baird Advisors
Municipal Fixed Income Market Commentary
May 2019

Municipal Yields Fall Led by Longer Maturities

The backdrop for the municipal market remained supportive last month with light new supply and strong demand pushing yields down across the curve. The streak of positive flows into tax-exempt funds continued, now with 21 consecutive weekly inflows totaling $36B of new money since year end. Issuance in May fell 22% from the same month last year which brought YTD tax-exempt supply back to unchanged from year ago levels after being up nearly 20% YoY in Q1. The rally in May was most pronounced among longer maturities where yields fell 25 bps; short-term rates fell 15 – 17 bps causing a bull flattening in the tax-exempt curve. Even with the sharp decline in municipal yields last month, the tax-exempt market still lagged the rally in Treasuries, which helped to improve the cross-market relative valuation between municipals and Treasuries. We expect that the favorable supply/demand backdrop will persist through the summer. Between maturities and calls the amount of municipal debt rolling off is expected to exceed new supply by an estimated $48B over the June – August period.

AAA Municipal Yields



Maturity	Dec 31, 2018	Apr 30, 2019	May 31, 2019	1Mo	YTD
1	1.74%	1.55%	1.40%	-0.15%	-0.34%
2	1.80%	1.58%	1.41%	-0.17%	-0.39%
3	1.85%	1.59%	1.42%	-0.17%	-0.43%
5	1.96%	1.65%	1.44%	-0.21%	-0.52%
7	2.09%	1.72%	1.51%	-0.21%	-0.58%
10	2.32%	1.89%	1.66%	-0.23%	-0.66%
30	3.09%	2.65%	2.40%	-0.25%	-0.69%

TCJA Provides States With A Strong Revenue Surprise in April

April's tax payments provided a very welcomed surprise to many states and municipalities. While it was expected that personal income tax revenues would rise following the passage of the Tax Cuts and Jobs Act (TCJA) of 2018, the amount by which it exceeded many state budgets was encouraging. For background, personal income taxes represent the largest source of revenue for most states, typically between 25% - 45% of total revenues, and because the TCJA broadened the income tax base and raised the adjusted gross income of many taxpayers, it led to a boost in personal income tax payments. Among the 32 states that have reported their April tax receipts, state income tax revenues had risen by an average of 6.4% YoY. The additional revenue provides states with more flexibility to perhaps boost spending, add to reserves, more easily meet rising pension costs, or some combination of the above. For example, for the first time in ten years New Jersey was able to put money into the state's rainy day fund. California was able to provide a one-time boost to education funding plus tackling homelessness. Illinois received an unexpected $1.5B revenue boost in April, which nearly erased the projected current year deficit, avoiding the need to extend the amortization of its pension payments or to add to its backlog of unpaid bills. State credit ratings largely reflect the sound financial position of most states. S&P currently rates one-half of U.S. states with either a AAA or AA+ rating. All but two states have a stable outlook from S&P and the two exceptions, Connecticut and Nevada, each carry a positive rating outlook. Moody's concurs with the same favorable ratings trend as municipal rating upgrades have exceeded downgrades across state and local governments for seven consecutive quarters. The long economic expansion and tax reform have strengthened municipal credits.

Positive Month Adds to Favorable YTD Returns

The rally in rates provided investors with another solid month of performance in May. Risk-seeking strategies continued to be rewarded as longer maturities outperformed intermediate and short-term debt for the month and YTD. Lower quality investment grade credit outperformed higher quality issues as well, as BBBs outperformed AAAs by 74 bps in May and lead on a YTD basis by 196 bps.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	May	YTD	Bloomberg Barclays Quality	May	YTD
Municipal Bond Index	1.38%	4.71%	AAA	1.20%	4.18%
General Obligation bonds	1.37%	4.53%	AA	1.30%	4.44%
Revenue bonds	1.44%	4.99%	A	1.46%	5.10%
Prerefunded bonds	0.63%	1.99%	BBB	1.94%	6.14%
Long maturities (22+ yrs.)	1.80%	6.59%	High Yield	1.62%	6.11%
Intermediate maturities (1 - 17 yrs.)	1.21%	3.97%	HY, ex-Puerto Rico	1.69%	5.76%
Short maturities (1 - 5 yrs.)	0.65%	2.01%			

Disclosures

This is not a complete analysis of every material fact regarding any company, industry or security. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

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.

Indices are unmanaged, and are not available for direct investment. *Past performance is not a guarantee of future results.*

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.