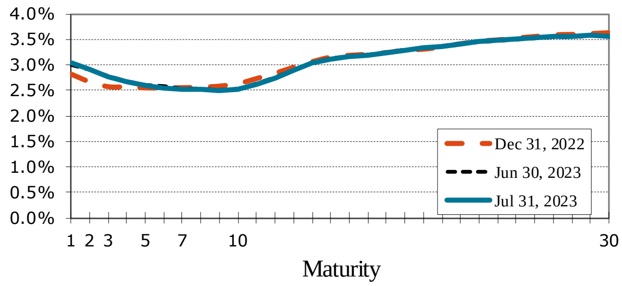
Baird Advisors
Municipal Fixed Income Market Commentary
July 2023

Yields Were Steady in July, Curve Inversion Persists

Tax-exempt rates traded in a narrow range in July and ended little-changed from the prior month end, leaving the municipal curve in a deeply inverted position between the 1yr – 10yr maturities. The steady yield backdrop was achieved despite relatively strong economic data including Q2 growth of 2.4%, better than the 1.8% consensus estimate. The Fed also followed through with the expected 25 bp rate hike, pushing the top-end of the federal funds target to 5.50%. Yet, the disinflation trend continued as both the CPI (3.0% YoY) and Core CPI (4.8% YoY) came in modestly below expectations. Also helping was a favorable technical backdrop for the municipal market. New issue volume was moderate, roughly matching last July's total of $27B which leaves YTD total issuance (including taxable) still off 15% YoY (tax-exempt issuance only is down 9% YoY). Demand for municipals improved last month, helped both by relatively heavy reinvestment from bond calls/maturities and also from positive net fund flows of $1.3B. This was only the second month this year with positive flows reducing net outflows YTD to $6.8B. We expect August to be another month of relatively strong reinvestment demand, likely exceeding new issue volume.

AAA Municipal Yields



Maturity	12/31/22	3/31/23	6/30/23	7/31/23	1Mo Δ	YTD Δ
1	2.82%	2.47%	3.01%	3.04%	0.03%	0.22%
2	2.67%	2.41%	2.92%	2.93%	0.01%	0.26%
3	2.58%	2.30%	2.77%	2.77%	0.00%	0.19%
5	2.56%	2.23%	2.61%	2.59%	-0.02%	0.03%
7	2.56%	2.22%	2.54%	2.51%	-0.03%	-0.05%
10	2.64%	2.28%	2.55%	2.53%	-0.02%	-0.11%
30	3.63%	3.38%	3.57%	3.57%	0.00%	-0.06%

Detroit Update – 10 Years Post-Bankruptcy

Ten years ago, Detroit filed for Chapter 9 bankruptcy protection with $18B in liabilities, a shrinking population and tax base illustrated by 47,000 vacant houses. At the time it was the largest municipal bankruptcy in history (that distinction now lies with Puerto Rico). It was ironic, then, that on the tenth anniversary date of its filing Detroit issued $100 million of new unlimited tax, general obligation (UTGO) debt in the municipal market – and it was wildly oversubscribed by investors. This is a testament both to strides the city has made over the last decade, with significant help from the state, and a relatively attractive new issue pricing even for the added risk. $75M of this issue was a self-designated "Social Bond," part of its Neighborhood Improvement Plan which involves the demolition or restoration of vacant houses. The goal is to help reduce blight, enabling property values to climb and tax millage rates to fall. Over the last five years, the city's population has stabilized at more than 650,000 as both businesses and individuals have elected to stay or return. Detroit's credit rating fell below investment grade in 2009, well ahead of the bankruptcy filing, and remains there today by both Moody's (Ba1) and S&P (BB+), but each also now has a Positive outlook on the rating, suggesting an investment grade rating is possible if progress continues. In fact, S&P noted that Detroit's "financial position and economic conditions are the strongest they've been in decades." In addition to eliminating approximately $7B in debt as part of the bankruptcy plan of adjustment, Detroit was also provided a ten-year holiday from pension payments. That holiday is ending in FY2024, but fortunately the city has set aside reserves to help partially offset the actuarily determined payments when they resume. Long-term challenges still exist for Detroit, but their revival shows not only the ability for municipalities to rebound (although rarely through bankruptcy) but also a market acceptance if sufficient progress is made and investor confidence restored.

Positive July Adds to Solid YTD Returns

Stable yields in July provided a month in which income largely determined relative returns across the market. Not surprisingly, the higher yielding Revenue sector outperformed both GOs and Pre-refunded issues for the month. The same theme carried over to the quality categories where BBBs outperformed higher-rated issues, although High Yield issues lagged modestly. Finally, the intermediate segment of the curve outperformed both shorter and longer maturities in July.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	July	YTD	*Duration*	Bloomberg Quality	July	YTD	*Duration*
Municipal Bond Index	0.40%	3.08%	*6.05*	AAA	0.16%	2.24%	*5.53*
General Obligation bonds	0.27%	2.46%	*5.73*	AA	0.37%	2.79%	*6.09*
Revenue bonds	0.46%	3.47%	*6.38*	A	0.53%	3.78%	*6.04*
Prerefunded bonds	0.13%	0.95%	*2.20*	BBB	0.85%	5.34%	*7.45*
Long maturities (22+ yrs.)	0.35%	5.33%	*10.19*	High Yield	0.65%	5.11%	*7.51*
Intermediate maturities (1 - 17 yrs.)	0.39%	2.25%	*4.51*	HY, ex-Puerto Rico	0.74%	4.21%	*7.33*
Short maturities (1 - 5 yrs.)	0.24%	1.23%	*2.34*				

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 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 Municipal Bond Index and do not represent separate indices.

The Bloomberg 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 Municipal Bond Index or Bloomberg 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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