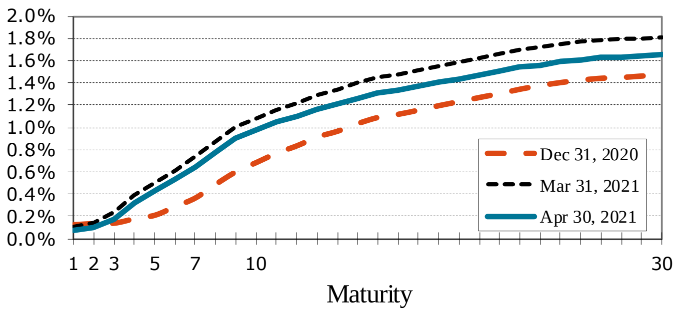
Baird Advisors
Municipal Fixed Income Market Commentary
April 2021

Municipal Curve Flattens as Demand Overwhelms Even Rising Levels of Supply

Tax-exempt yields fell in April led by the decline in long-end yields. While short-term yields slipped 2-4 bps, long rates fell 16 bps, flattening the curve. Tax-exempt yields largely tracked the decline in Treasury yields this month even with strong economic data and rising inflation. Demand for tax-exempts was very strong; evident in inflows every week of the month and the record $41.5B of municipal fund inflows YTD, which already qualifies as the fourth-highest amount for any full calendar year since at least 1992. Talk of higher taxes is certainly contributing to the tone as investor demand overwhelmed even a rising level of new supply. April's issuance of $40B easily outpaced the $32B in the same month a year ago amidst the pandemic uncertainty. YTD supply of $151B is up 18% YoY and includes $44B (29% of total volume) of taxable municipals. Yet, it is easy to see how the rising supply has been readily absorbed when the fund inflows are combined with an estimated $170B of maturity/call redemptions and coupon payments YTD. Bond scarcity – rather than abundance – has been the larger issue for investors in recent weeks. Not surprisingly, tax-exempt valuations remain relatively rich when compared to similar-maturity Treasuries and nothing on the near-term horizon is likely to alter this trend. Even if rates stabilize and trend higher in coming months, as many expect, demand for tax-exempt income is strong and higher yields would likely be welcomed rather than feared by most investors.

AAA Municipal Yields



Maturity	12/31/20	3/31/21	4/30/21	1Mo Δ	YTD Δ
1	0.13%	0.10%	0.08%	-0.02%	-0.05%
2	0.14%	0.14%	0.10%	-0.04%	-0.04%
3	0.14%	0.24%	0.17%	-0.07%	0.03%
5	0.22%	0.50%	0.43%	-0.07%	0.21%
7	0.37%	0.73%	0.65%	-0.08%	0.28%
10	0.69%	1.08%	0.98%	-0.10%	0.29%
30	1.47%	1.81%	1.65%	-0.16%	0.18%

Municipal Investors Digest Tax and Infrastructure Plan Implications

President Biden outlined his broad agenda on spending and taxes before a Joint Session of Congress in late April, including $4T of legislative proposals. The $2.25T American Jobs Plan (AJP), which was announced in March, focuses on infrastructure needs, the cost of which would be offset by higher corporate taxes. He also outlined the American Families Plan (AFP) which would spend $1.8T on social programs and be paid for through higher personal taxes. The proposals increase the corporate tax rate to 28% (from 21%), and the top individual tax rate – for those earning more than $400,000 – to 39.6% (from 37%). Capital gains taxes, for those with over $1 million in income, would rise to 43.4% (39.6% plus the 3.8% Medicare Investment Tax). Congress is also debating a relaxation (if not full repeal) of the $10,000 cap on state and local taxes, but this would reduce much-needed revenue for President Biden's aggressive agenda. Municipalities are also anticipating the potential return of tax-exempt advance refundings, repealed in the tax reform act of 2017, which would provide more financing flexibility. It is understood that municipal debt would play a key role in any infrastructure borrowing plan. This has led to discussions of providing a federal subsidy to municipalities that borrow in the taxable market for infrastructure needs, like the Build America Bond (BAB) program of 2009-10. In addition to lowering the cost of borrowing, this would also help to broaden the buyer base. At the same time, more taxable borrowing would minimize tax-exempt supply, supporting current valuations.

Longer Maturities and Lower-Quality Outperformed in April

All segments of the municipal market provided positive returns in April. Risk, however, was particularly rewarded this month as the flattening curve led to the outperformance of longer maturities relative to shorter issues. In addition, lower-rated municipals continued their strong trend of outperformance relative to higher-quality credits as investors sought the additional yield. YTD BBBs have outperformed AAAs by 272 bps, and the difference is even greater for HY credits.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	April	YTD	Bloomberg Barclays Quality	April	YTD
Municipal Bond Index	0.84%	0.48%	AAA	0.74%	-0.17%
General Obligation bonds	0.73%	0.19%	AA	0.75%	0.09%
Revenue bonds	0.94%	0.65%	A	0.94%	1.00%
Prerefunded bonds	0.16%	0.03%	BBB	1.26%	2.55%
Long maturities (22+ yrs.)	1.39%	0.91%	High Yield	1.46%	3.61%
Intermediate maturities (1 - 17 yrs.)	0.63%	0.30%	HY, ex-Puerto Rico	1.42%	3.80%
Short maturities (1 - 5 yrs.)	0.22%	0.30%			

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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