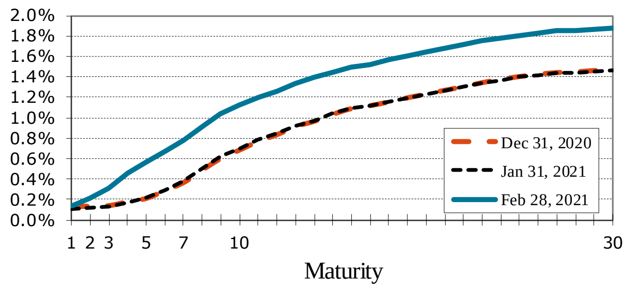
Baird Advisors
Municipal Fixed Income Market Commentary
February 2021

Municipals Yield Rise on Inflation Concerns

U.S. fixed income yields rose in February due to concerns that outsized fiscal stimulus paired with the reopening of the economy may spark inflation. The Fed furthered the notion by underscoring an acceptance of higher inflation and viewed the rise in yields as a positive reflection of an economic rebound. Tax-exempt yields held steady early in the month even as Treasury yields continued their upward trend since year end. The result was a richening of tax-exempt values relative to Treasuries. By mid-month, municipal-to-Treasury yield valuations were at record lows causing buying interest to wane. Yet, valuations quickly corrected thanks to a sharp rise in municipal yields in the second half of February. For the month, the curve steepened and 10-year AAA municipal yields rose 42 basis points, ending February at its highest level since May of 2020. While higher municipal yields should be more appealing to investors, the process of prices falling and yields climbing often results in slowing demand, at least at the outset. This held true in February as industry fund inflows slowed although remained positive. Net fund inflows through February of \$26B are just ahead of last year's pace while total municipal supply has been modest. YTD issuance of \$63B is down from \$78B at this point in 2020 and tax-exempt issuance of \$41B YTD is down 22% YoY.

AAA Municipal Yields



Maturity	12/31/19	12/31/20	1/31/21	2/28/21	1Mo Δ	YTD Δ
1	1.06%	0.13%	0.11%	0.14%	0.03%	0.01%
2	1.06%	0.14%	0.12%	0.21%	0.09%	0.07%
3	1.07%	0.14%	0.13%	0.31%	0.18%	0.17%
5	1.14%	0.22%	0.22%	0.57%	0.35%	0.35%
7	1.25%	0.37%	0.38%	0.78%	0.40%	0.41%
10	1.48%	0.69%	0.70%	1.12%	0.42%	0.43%
30	2.15%	1.47%	1.46%	1.87%	0.41%	0.40%

Winter Storm Uri Cripples Texas at Great Economic Impact

Ice, snow and frigid temperatures descended on much of the country during the third week of February. Most of Texas experienced sub-freezing temperatures which caused electrical generation equipment and natural gas pipelines to freeze. The extreme environmental event (described by some as a "catastrophic 'black swan' event") took out power production from multiple sources, including coal, natural gas, nuclear and wind. As the demand for power rose well above available supply the result was rolling blackouts across much of the state, often for many days, nearly collapsing the state's power grid. Four million residents and businesses lost power and even more had water issues due to freezing and broken pipes. Initial cost estimates are very high when including the lost economic value, even exceeding either Hurricane's Harvey and Katrina, which cost \$130B and \$165B, respectively. President Biden declared much of the state a disaster area and ordered FEMA to supplement state and local recovery efforts with federal support. The Electric Reliability Council of Texas (ERCOT) maintains and operates much of the state's electricity grid and is overseen by the Public Utility Commission of Texas. Each entity has been severely criticized for the lack of preparation and management through the crisis and both the causes and costs in the aftermath of this weather even will be evaluated for years. From a credit perspective, we expect that whatever costs are not reimbursed by federal and/or state authorities will be spread out over many years, raising the cost of power to both retail and business customers.

Rising Rates Produce Negative February Returns

Prospects for a stronger economy resulted in higher yields and a steeper municipal yield curve in February, pushing returns into negative territory. Shorter curve segments outperformed both intermediate and longer maturities as the curve steepened in the sell-off. Not surprisingly, the pre-refunded sector outperformed other, longer duration sectors of GOs and Revenue bonds as a result. Finally, BBB-rated municipals outperformed AAA-securities for the month and broadened the performance gap YTD as credit spreads continued to narrow.

Total Returns of Selected Bloomberg Barclays Municipal Indices and Subsectors

Bloomberg Barclays Index/Sector	February	YTD	Bloomberg Barclays Quality	February	YTD
Municipal Bond Index	-1.59%	-0.96%	AAA	-1.72%	-1.41%
General Obligation bonds	-1.69%	-1.16%	AA	-1.65%	-1.22%
Revenue bonds	-1.65%	-0.94%	A	-1.46%	-0.59%
Prerefunded bonds	-0.42%	-0.25%	BBB	-1.38%	0.37%
Long maturities (22+ yrs.)	-2.41%	-1.45%	High Yield	-1.05%	1.02%
Intermediate maturities (1 - 17 yrs.)	-1.26%	-0.79%	HY, ex-Puerto Rico	-0.84%	1.18%
Short maturities (1 - 5 yrs.)	-0.40%	-0.17%			

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.

JG2020-1203*