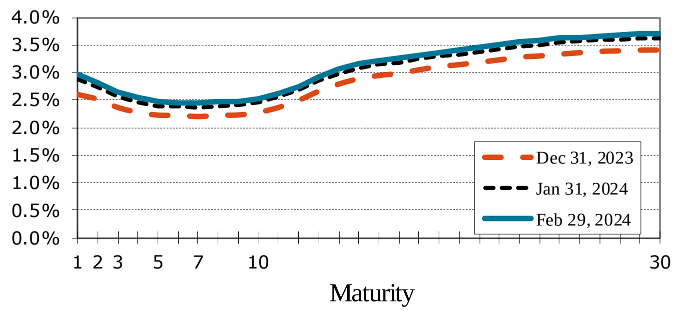
Baird Advisors
Municipal Fixed Income Market Commentary
February 2024

Strong Demand Meets Increased Supply

Yields moved modestly higher in a uniform manner in February, with rates up between 7 – 9 bps across the yield curve. Virtually all the yield movement occurred in the first half on the month, thanks to strong economic data, including 353,000 new hires in the January payroll report and a 3.9% YoY rise in Core CPI, both above consensus estimates. Contributing to the modest upward yield pressure was a second consecutive month of relatively robust supply, as issuers were ready to match the strong demand for municipal debt. In February, tax-exempt issuance was 58% above the same month last year which brings total YTD supply of new issue tax-exempts to $60.2B, 55% ahead of last year's pace. YTD taxable supply is also up, rising 12% YoY. Of note, part of the boost in tax-exempt supply has been driven by issuers refinancing taxable debt, including some Build America Bond (BAB) issues, with tax-exempt debt, thanks to the rich relationship between tax-exempt and taxable yields. On the demand side, investor interest in the market was evident in the oversubscription of many new issues, but also in the continued inflows to municipal mutual funds. Through February, there have been $4.6B of net municipal fund purchases YTD, clearly breaking the outflow trend of last year.

AAA Municipal Yields



Maturity	12/31/22	12/31/23	1/31/24	2/29/24	1Mo Δ
1	2.82%	2.59%	2.88%	2.97%	0.09%
2	2.67%	2.50%	2.73%	2.82%	0.09%
3	2.58%	2.35%	2.56%	2.64%	0.08%
5	2.56%	2.22%	2.40%	2.47%	0.07%
7	2.56%	2.19%	2.37%	2.44%	0.07%
10	2.64%	2.27%	2.46%	2.53%	0.07%
30	3.63%	3.40%	3.62%	3.70%	0.08%

State Credit Remains Strong Despite Slowing Revenues

The credit backdrop for state and local municipalities has been improving since the economy reopened post-Covid. Recent credit agency data confirms this favorable trend of the last few years. Combining both Moody's and S&P rating changes, the upgrade to downgrade ratio in 2021 was 2:1, 3:1 in 2022 and over 4:1 for all of 2023. In addition, the National Association of State Budget Officers (NASBO) recently reported that the median state rainy day fund balance, 11% of general fund expenditures, was the highest level since at least 2000. The two key reasons for the elevated reserve levels and improving credit trend are 1) the Covid-related fiscal support received and 2) the surprisingly strong economic recovery which boosted tax revenues. While the current credit backdrop is strong, looking forward, states (and investors) would be wise to anticipate a moderation in this trend as tax receipts slow, or fall, and cost pressures rise. In fact, JP Morgan estimates that state tax receipts likely fell by 1.5% in 2023. At the local level, pressure on commercial real estate prices, particularly office property valuations, is evident and may negatively impact property tax revenues. Fortunately, the adjustments in office valuations are likely manageable even as the directional trend is negative. According to Bloomberg, a recent study out of Tufts University, based in part on a McKinsey & Co. estimate, noted that office values could drop by 30% or more through the end of the decade. However, the impact by city varies. Major cities, such as Chicago, Miami, New York and Washington, DC saw a relatively small impact to tax revenues according to the study. Boston's property tax revenue contributes to approximately 1/3 of the city's overall tax revenue and the city may see property taxes fall by $1B over the next 5 years. While a large number, it should be manageable for a city the size of Boston.

Positive Returns in February

Returns across the municipal market were positive in February. Longer maturities marginally outperformed both intermediate and short-term issues despite the rise in rates. Revenue bonds outperformed both GOs and Prerefundeds among market sectors. By rating, lower-quality securities outperformed higher-quality, as A and BBB rated issues led AAA issues. High Yield municipals were the best performing category for the month and YTD.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	February	YTD	*Duration*	Bloomberg Quality	February	YTD	*Duration*
Municipal Bond Index	0.13%	-0.38%	*6.09*	AAA	-0.03%	-0.68%	*6.37*
General Obligation bonds	0.01%	-0.54%	*5.80*	AA	0.09%	-0.42%	*5.94*
Revenue bonds	0.18%	-0.34%	*6.35*	A	0.27%	-0.14%	*5.99*
Prerefunded bonds	0.03%	0.09%	*2.17*	BBB	0.37%	-0.14%	*7.29*
Long maturities (22+ yrs.)	0.15%	-0.74%	*10.06*	High Yield	0.79%	0.32%	*7.08*
Intermediate maturities (1 - 17 yrs.)	0.10%	-0.29%	*4.56*	HY, ex-Puerto Rico	0.66%	0.07%	*7.06*
Short maturities (1 - 5 yrs.)	0.11%	-0.07%	*2.33*				

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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