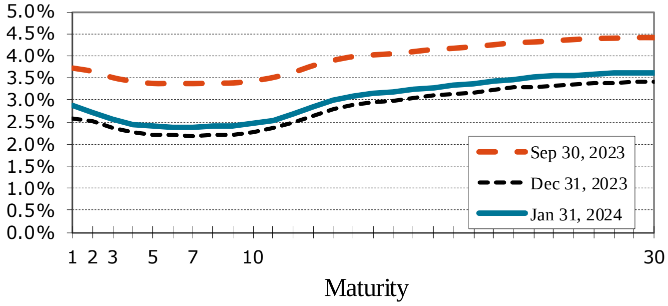
Baird Advisors
Municipal Fixed Income Market Commentary
January 2024

Tax-exempt Yields Rise as Supply Returns to the Market

In a reversal from the strong rally at the end of 2023, municipal yields rose approximately 20 bps in January across much of the curve. Short-term rates rose the most, with 1yr yields up 29 bps in the month, thanks to continued volatility in the SIFMA floating rate tax-exempt index. After falling to 1.90% on January 10th, the SIFMA rate spiked to 4.55% over the next two weeks as dealer inventory of floating rate paper ebbed and flowed significantly. Further out the curve, the 10yr tax-exempt yield ended January at 2.46%, up 19 bps compared to a 3 bp rise in 10yr Treasury yields, marginally improving the relative value of tax-exempt bonds during the month. Although demand for municipals was robust to start the year, supply also rose. Based only on weekly reporting municipal funds, tax-free funds had $2.1B of net inflows in January. With four consecutive weeks of net industry inflows, not only are the tax-loss trades from Q4 being reversed but investors are also likely considering the potentially negative impact that Fed rate cuts may have on the yield for cash and other short-term vehicles over the next several months. Also supporting demand was roughly $34B in principal and interest payments on existing municipal debt that holders received in January. Fortunately, there was also ample supply to digest as new issuance of $30B, which was up 53% from January 2023, came to market in the month. Borrowing needs may grow this year if state and local tax receipts ease and municipalities budget for a possible economic slowdown.

AAA Municipal Yields



Maturity	12/31/22	9/30/23	12/31/23	1/31/24	1Mo Δ
1	2.82%	3.73%	2.59%	2.88%	0.29%
2	2.67%	3.65%	2.50%	2.73%	0.23%
3	2.58%	3.51%	2.35%	2.56%	0.21%
5	2.56%	3.38%	2.22%	2.40%	0.18%
7	2.56%	3.38%	2.19%	2.37%	0.18%
10	2.64%	3.44%	2.27%	2.46%	0.19%
30	3.63%	4.42%	3.40%	3.62%	0.22%

Airports Begin 2024 in Good Shape

The US airport sector rebounded faster from the Covid-related decline than it did after the Great Recession in 2008-2009. Passenger traffic ended 2023 up 2% relative to pre-pandemic (2019) levels and 13% ahead of 2022 levels. Not surprisingly, credit quality in the sector has also recovered. After widespread downgrades from the impact of the pandemic, rating agencies now indicate the worst is behind the sector. While credit quality is strong, most airports paused capital spending amid the pandemic. S&P estimates there are $151B in capital improvements that need to be financed in the next couple of years to account for increased traffic. Leisure travel is back, and business traffic also continues to improve. In addition, airports still have unspent Covid-recovery funds on their balance sheets and new funds flowing their way from the 2021 Infrastructure and Jobs Act. However, we expect airports to fund a portion of their capital needs in 2024 in the municipal market. Additional borrowing, particularly by some of the largest and most-trafficked airports, may provide an opportunity to add exposure to the sector over time despite current narrow credit spreads. Debt issued that is subject to the Alternative Minimum Tax (AMT) may offer an opportunity to invest in a higher-quality sector at attractive levels relative to non-AMT offerings.

Modestly Negative Returns to Start 2024

January gave back some of the impressive performance from the end of last year with modestly negative returns in the month. Although short rates rose the most, this maturity segment still outperformed other parts of the curve. The shorter average maturity Pre-refunded sector outperformed both the GO and Revenue bond sectors. Across the quality spectrum, there was little difference in performance this month, although A-rated issues marginally outperformed other categories.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	2023	January	*Duration*	Bloomberg Quality	2023	January	*Duration*
Municipal Bond Index	6.40%	-0.51%	*6.10*	AAA	5.80%	-0.65%	*6.26*
General Obligation bonds	5.62%	-0.55%	*5.78*	AA	5.92%	-0.51%	*5.95*
Revenue bonds	6.89%	-0.52%	*6.37*	A	7.34%	-0.41%	*6.03*
Prerefunded bonds	2.99%	0.06%	*2.18*	BBB	8.93%	-0.51%	*7.39*
Long maturities (22+ yrs.)	9.35%	-0.89%	*10.11*	High Yield	9.21%	-0.46%	*7.17*
Intermediate maturities (1 - 17 yrs.)	5.26%	-0.39%	*4.55*	HY, ex-Puerto Rico	7.92%	-0.59%	*7.11*
Short maturities (1 - 5 yrs.)	3.58%	-0.18%	*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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