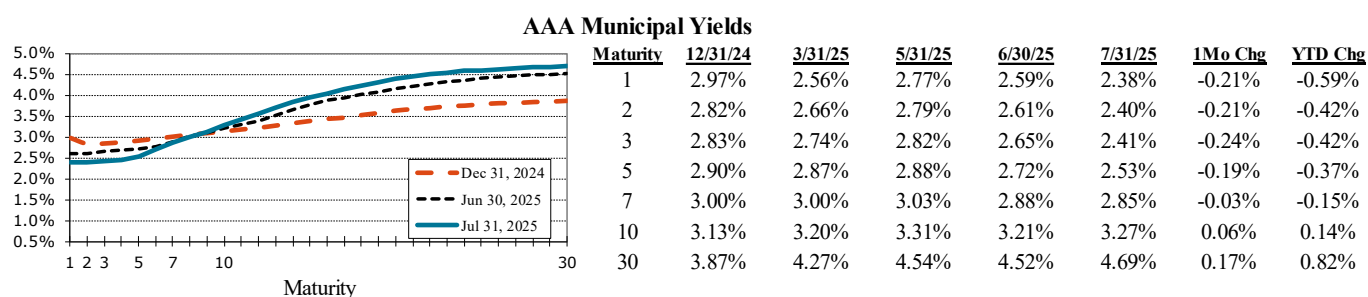


Baird Advisors
Municipal Fixed Income Market Commentary
July 2025

Municipal Curve Further Steepens as Record Pace of Supply Continues

The tax-exempt municipal curve continued its relentless steepening in July as short-term yields fell while long-term yields rose; 2yr yields fell 21 bps and the 30yr rose 17 bps. Cash yields were volatile as the SIFMA floating-rate index fell from a starting range of 1.92% to 1.63%, rose and peaked at 2.73% before closing the month at 2.29%. The 2 – 30yr slope of the municipal curve has more than doubled YTD, to +229 bps spread from +105 bps, and is now at its steepest slope since March 2017, offering investors incentive to extend duration to enhance yield and pick up roll down return. On the supply side, this month's \$57B total issuance set a new record for July, bringing the YTD total to \$341B, 21% ahead of last year's record pace. At the same time, there were net fund inflows of \$6.2B in July, helping to absorb some of the heavy issuance; YTD fund net inflows stand at \$15.6B. The passage of the One Big Beautiful Bill (OBBB) Act was a positive for the municipal market as it left the tax-exempt status of municipal debt untouched. The bill did include a tax on the endowment income of approximately twenty select universities (those with more than 3,000 students and an endowment per student greater than \$500,000). The bill also raised the State and Local Tax Deduction (SALT) to \$40,000 from \$10,000, subject to income limits. August is expected to see \$59B of principal and interest payments returned to investors, the most since June, which will help digest continued heavy supply.



Healthcare Effects of OBBS

The Healthcare sector will be negatively impacted by the OBBS. Current estimates indicate that changes made to Medicaid will cut \$1 trillion in funding over 10 years and may increase the number of uninsured by 11.8 million. All states will be affected by caps placed on Federal reimbursements and, as a result, each will need to evaluate how their own budget can support the federal funding gap. Rural hospitals, which serve a higher Medicaid payer mix, face a larger hit than larger multi-state systems. The bill does include a \$50B Rural Hospital Stabilization Fund to help alleviate some of those concerns. It is important to recognize that most of these changes do not go into effect until 2028, which gives both states and hospitals time to prepare and adjust spending accordingly. Per Fitch, nonprofit hospital margins have been improving, rising to 1.2% in CY24 from -0.5% in CY23, as providers have been able to transition away from more expensive contract labor. Further, according to the National Association of State Budget Officers (NASBO) Spring Report, state general fund spending is projected to grow at a 0.8% rate in FY26, down from a high of 16% in 2022. State rainy day funds remain near record levels at 12.9% of General Fund balances, down from a pandemic high of 14.6%, but well above pre-pandemic levels. While the budget cuts are undeniably a headwind for the Healthcare sector, with state support and sound management, we anticipate they will be able to adjust and adapt to the new policy environment.

Negative Returns in July

Rising yields across much of the curve led to negative monthly returns for most of the municipal market. Given the curve steepening, short- and intermediate-term maturities outperformed longer maturities. By quality, BBB-rated issues lagged higher-quality issues in both the month and YTD as credit spreads widened. From a sector perspective, Prerefunded issues, given their shorter average duration, outperformed other sectors for the month and YTD. Given recent turbulence in the High Yield (HY) municipal market, Investment Grade is now outperforming HY for the month and YTD.

Total Returns of Selected Barclays Municipal Indices and Subsectors

<u>Bloomberg Index/Sector</u>	<u>July</u>	<u>YTD</u>	<u>Duration</u>	<u>Bloomberg Quality</u>	<u>July</u>	<u>YTD</u>	<u>Duration</u>
Municipal Bond Index	-0.20%	-0.55%	7.03	AAA	-0.27%	-0.70%	7.16
General Obligation bonds	-0.16%	-0.44%	6.64	AA	-0.14%	-0.48%	6.91
Revenue bonds	-0.23%	-0.65%	7.26	A	-0.18%	-0.45%	7.02
Prerefunded bonds	0.64%	2.68%	2.39	BBB	-0.70%	-1.20%	7.94
Long maturities (22+ yrs.)	-1.08%	-4.42%	11.51	High Yield	-1.51%	-1.83%	8.04
Intermediate maturities (1 - 17 yrs.)	0.25%	1.35%	5.16	HY, ex-Puerto Rico	-1.57%	-1.61%	7.95
Short maturities (1 - 5 yrs.)	0.74%	2.82%	2.32				

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. *Past performance is not a guarantee of future results.*

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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