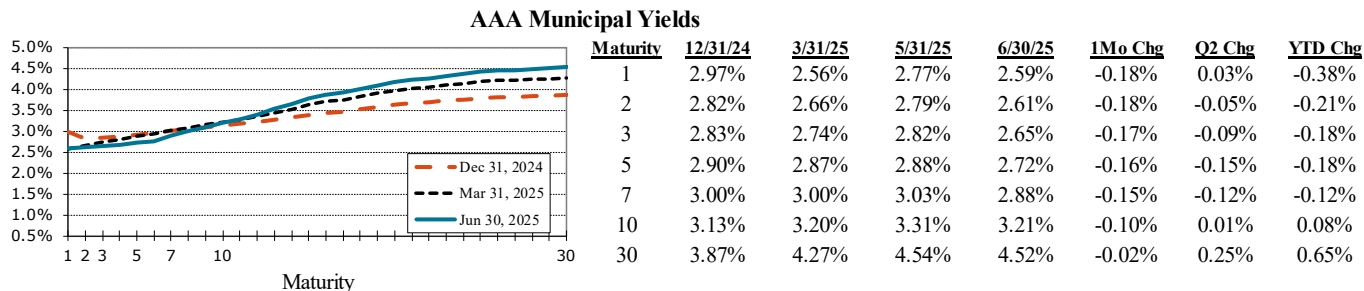


Baird Advisors
Municipal Fixed Income Market Commentary
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Municipal Yields Mixed in Q2 Amid Record Supply and Strong YTD Curve Steepening Trend

Tax-exempt rates fell in June with a steepening bias as short-term rates fell more than longer yields. For the quarter, however, yields were mixed as both short and long rates rose while intermediate rates fell. Yet, curve steepening was the dominant trend YTD. Since year end, short-term yields fell 38 bps while long rates rose 65 bps, leading to 103 bps of steepening between the 1-30yr maturities. The result is the steepest 1s-30s curve slope in at least the last five years, at +193 bps, offering significant incentive for investors to extend to enhance yield and roll-down benefits – making maturity selection a particularly important decision. To illustrate, if the AAA curve slope were unchanged over the next twelve months, the total return (yield + roll) of a 7yr bond now offers 51 bps higher return than a 6yr bond (with only a modest duration difference) while a 13yr bond achieves the highest total return of any point on the curve, including among much longer maturities. It's also worth noting how municipal returns lagged those of comparable taxables in the first half of 2025. One of the main reasons was a record level of new municipal supply (see below) as well as the concern over potential changes to the tax status of municipal debt from the One Big Beautiful Bill Act (OBBA). Fortunately, neither the House nor Senate versions currently include anything that will meaningfully impact the municipal tax-exemption, which helped to improve the market tone near quarter-end. While demand for municipals briefly paused in early-April during the volatile Liberation Day tariff announcement, interest in the municipal market rebounded, leading to net fund inflows YTD of \$9.4B. Investor demand slightly favored Investment Grade funds (\$5.2B) over High Yield funds (\$4.2B), which contributed to modest spread widening (BBBs widened 8 bps YTD to +97 bps). Heavy reinvestment demand from maturities, early calls and coupon payments is expected through July and August, providing a solid outlook over the balance of the summer season.



Record Municipal Supply

A key story of the municipal market in the first half of 2025 has been the furious pace of issuance. YTD total tax-exempt supply is at \$285B, up 18% relative to 2024, which was a record year itself. Reasons for increased issuance includes borrowers wanting to get ahead of any potential tax changes from the OBBA, the need for funds as municipalities exhaust their COVID-related federal stimulus resources and pent-up demand for infrastructure investment. When analyzed by maturity, issuance was heaviest beyond the 10yr maturity range with 22+ year maturities as the largest portion overall. Not surprisingly, the heavy long-end issuance contributed to the curve steepening discussed above. From a sector perspective, the largest YoY supply increase was in the Education sector, which includes both Higher Education (colleges/universities) as well as local school districts. College/university borrowing, beyond the ongoing need to enhance campus facilities, was also spurred by a desire to shore up liquidity ahead of new/higher taxes on the endowments of select universities. Most local school district borrowings were used to upgrade facilities.

Positive Returns in June but Mixed Results in Q2 and YTD

June returns were positive as municipal yields fell, but performance varied by maturity for the quarter and YTD. Through all the time periods, however, longer maturities underperformed shorter maturities given the curve steepening trend. Not surprisingly, the shorter duration Prerefunded sector outperformed both GOs and REVs over all periods. Higher-quality bonds outperformed lower-quality for the quarter, given the modest spread widening that occurred, and BBBs were the worst performer YTD.

Total Returns of Selected Barclays Municipal Indices and Subsectors

<u>Bloomberg Index/Sector</u>	<u>June</u>	<u>Q2</u>	<u>YTD</u>	<u>Duration</u>	<u>Bloomberg Quality</u>	<u>June</u>	<u>Q2</u>	<u>YTD</u>	<u>Duration</u>
Municipal Bond Index	0.62%	-0.12%	-0.35%	6.78	AAA	0.54%	-0.09%	-0.43%	6.89
General Obligation bonds	0.59%	0.00%	-0.28%	6.40	AA	0.61%	-0.04%	-0.34%	6.66
Revenue bonds	0.63%	-0.20%	-0.42%	7.00	A	0.68%	-0.24%	-0.27%	6.80
Prerefunded bonds	0.76%	1.10%	2.03%	2.39	BBB	0.76%	-0.64%	-0.51%	7.60
Long maturities (22+ yrs.)	0.31%	-1.94%	-3.38%	11.09	High Yield	0.59%	-1.14%	-0.33%	7.58
Intermediate maturities (1 - 17 yrs.)	0.76%	0.70%	1.09%	5.01	HY, ex-Puerto Rico	0.55%	-0.91%	-0.04%	7.48
Short maturities (1 - 5 yrs.)	0.71%	1.06%	2.07%	2.31					

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.

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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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