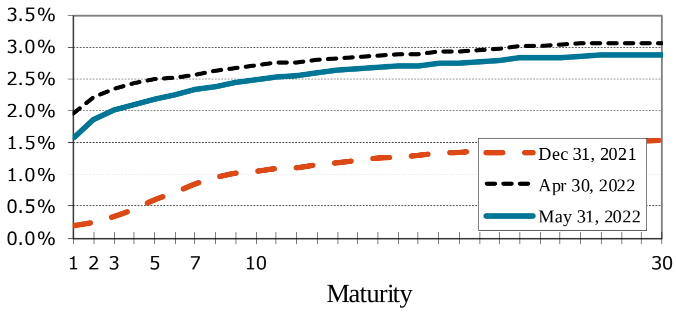
Baird Advisors
Municipal Fixed Income Market Commentary
May 2022

Mid-Month Pivot in Municipal Yields and Industry Fund Flows

May could be viewed as a tale of two markets in a single month. The relentless year-to-date move higher in yields continued during the first two weeks of May with 10yr AAA yields rising by 26 bps until signs of a slowing economy and falling equity prices helped to stabilize both Treasury and municipal yields. A sharp rally then ensued as municipal yields reversed all the rise and more, ending May down 22 bps. Impressively, the rally in tax-exempt yields was even stronger than in Treasuries helping to bring the cross-market relationship back in line with long-term valuations from the previously oversold condition. Accentuating the decline in tax-free rates was a reversal of municipal fund flows. After experiencing net redemptions for 20 consecutive weeks, flows finally turned positive in the last several days of the month. Even with the rally in May, tax-free yields are still up between 135 – 168 bps YTD at various points along the curve. YTD fund outflows of $58B exceed the outflows in 2020 during the pandemic's onset and are roughly equivalent to the 2013 calendar year outflows during the taper tantrum. Not surprisingly, the higher rates this year have dramatically slowed refunding activity, leading to a YoY decline in taxable municipal issuance of nearly 30%. Tax-exempt issuance continues at a steady but manageable pace; supply is up 6.5% YoY which is helping to finance new money infrastructure projects.

AAA Municipal Yields



Maturity	12/31/21	4/30/22	5/31/22	1Mo Δ	YTD Δ
1	0.19%	1.96%	1.58%	-0.38%	1.39%
2	0.25%	2.22%	1.86%	-0.36%	1.61%
3	0.34%	2.35%	2.02%	-0.33%	1.68%
5	0.60%	2.50%	2.19%	-0.31%	1.59%
7	0.85%	2.57%	2.33%	-0.24%	1.48%
10	1.05%	2.72%	2.50%	-0.22%	1.45%
30	1.54%	3.07%	2.88%	-0.19%	1.34%

Strong Fundamentals and Improving Supply/Demand Outlook for the Summer Period

Recent tax revenue data continue to confirm the strong fundamental credit backdrop for the municipal market. State and local governments experienced record tax collections in April thanks to the capital gains taxes paid on strong market returns of 2021. In addition, the strong post-pandemic economic rebound continues to show up in higher state and local personal and corporate income taxes as well as higher sales tax revenue. The result is record state budget surpluses. For example, California now expects a $98B surplus in its current fiscal year ending in June. Other states, such as Texas, with an expected $24B surplus, along with Michigan, Connecticut, Minnesota, Florida are expecting similar relative surplus levels. The State Treasurer of New Jersey recently stated that the fiscal picture for that state is "remarkably strong" as they raised the fiscal year revenue estimate by 9% from the previous March forecast. Adding to the flush condition of state and local governments is the distribution of the remaining $100B of ARPA (American Rescue Plan Act) funds from the $350B directed toward state and local governments. Although this post-pandemic aid was expected and is largely allocated, it remains unspent and will help to further support municipal credits. Beyond this fundamental strength, the technical (supply/demand) outlook for this summer seasonal period is also quite positive. During the four months of May through August, the amount of bonds rolling off from maturities and call dates, combined with the coupon payments, will exceed the amount of new supply by approximately $40B. Although the direction of rates remains uncertain, what can be said is that the near-term outlook for the municipal market from both a fundamental and technical perspective is quite favorable.

Positive Returns in May as Rates Fall Across the Curve

A sharp pivot in rates mid-month led to positive returns across the municipal curve in May. The longer segment of the curve outperformed the short and intermediate maturity segments. From a credit perspective, higher-quality set the pace with rate declines leading their outperformance relative to lower-quality and High Yield issues for the month. Finally, the high-quality rally favored GO and pre-refunded sector outperformance, particularly when adjusted for duration.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	May	YTD	*Duration*
Municipal Bond Index	1.49%	-7.47%	*6.10*
General Obligation bonds	1.54%	-7.18%	*5.70*
Revenue bonds	1.47%	-7.96%	*6.56*
Prerefunded bonds	1.36%	-2.85%	*2.48*
Long maturities (22+ yrs.)	1.81%	-11.30%	*10.78*
Intermediate maturities (1 - 17 yrs.)	1.41%	-6.01%	*4.43*
Short maturities (1 - 5 yrs.)	1.16%	-3.15%	*2.36*

Bloomberg Quality	May	YTD	*Duration*
AAA	1.59%	-7.10%	*5.92*
AA	1.65%	-7.17%	*5.96*
A	1.24%	-7.74%	*6.12*
BBB	0.95%	-9.17%	*7.29*
High Yield	1.10%	-8.86%	*9.42*
HY, ex-Puerto Rico	1.08%	-8.91%	*9.45*

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.

Robert W. Baird & Co. Incorporated.

This is not a complete analysis of every material fact regarding any company, industry or security. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy. Indices are unmanaged and are not available for direct investment.