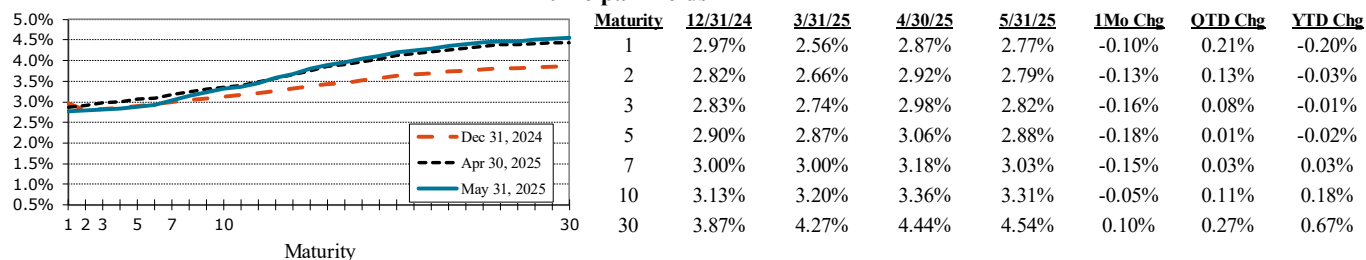


Baird Advisors
Municipal Fixed Income Market Commentary
May 2025

The Municipal Curve Steepened in May as Heavy Supply Continues

The tax-exempt curve continued to steepen in May as short- and intermediate-term yields fell while long-term yields rose. Among fixed-rate issues, yields in the 5yr segment fell the most (-18bps) as 30yr yields rose (10 bps). Cash yields, as measured by the volatile SIFMA floating-rate index, fell as low as 1.74% in May from an April peak of 4.41%, further steepening the curve. YTD, the 1 – 30yr slope of the municipal curve has nearly doubled to +177 bps spread from +90 bps – illustrating the incentive investors now have to extend to enhance yield. Heavy supply has certainly played a role in the steepening trend, as the \$53B issued in May was a record for the month, bringing YTD issuance to \$226B which is 17% ahead of last year's record pace. At the same time, there were net fund outflows of \$0.8B in May following the heightened volatility of April. However, total fund/ETF flows YTD remain positive at \$5.9B. Heavy reinvestment demand over the summer months should provide a favorable backdrop for the market, even as we expect supply to remain steady. Municipal investors were pleased that the passage of the "Big Beautiful Bill" in the House left the municipal market largely untouched. Included in the bill is an increase in the state and local tax (SALT) deduction, to \$40,000 from \$10,000, which would slightly reduce demand in high-tax states (although the \$500,000 income limit minimizes the impact). Beyond this, an endowment income tax would increase expenses for select universities with a large endowment/student ratio. The bill now heads to the Senate where we expect changes to be made before final passage.

AAA Municipal Yields



AAA Credit Exposure in the Municipal Market

In May, Moody's Investors Service downgraded the rating of the United States Government to Aa1 from Aaa, noting concerns over the nation's growing debt and interest costs (S&P and Fitch had lowered the rating in 2011 and 2023, respectively). The most direct impact of the US downgrade on the municipal market was the lowered rating of the Prerefunded/ETM sector (since escrow accounts are invested in US government securities) as well as some federally guaranteed housing issues. However, many AAA-rated municipal credits remain, representing 17% of the Bloomberg Municipal Index. Further, these AAA ratings span several sectors of the municipal market, including State GOs, Local GOs, Water & Sewer and Dedicated Tax, to name a few. There are currently twelve states rated AAA by all three rating agencies (DE, FL, GA, IN, MN, MO, NC, OH, TN, TX, UT, VA) based on their relative financial rankings to other state and municipal credits. For example, in the April affirmation of North Carolina's AAA rating, S&P cited the state's strong economic growth trends, history of prudent fiscal management and low-to-moderate debt burden. Moody's cites the state's GDP, which is growing at a 3.7% pace relative to Moody's state medians of 2.2% and reserves of \$25B, 58% of revenue compared to the state medians of 44%. While it may seem ironic that the US Treasury, which remains the largest, safest and most liquid financial market in the world, now has a lower credit rating than many municipal credits, the differentiation can be justified when each entity is judged relative to its category peers.

Positive Returns in May

Falling yields across much of the curve led to positive monthly returns across most segments 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 both for the month and YTD. Finally, from a sector perspective Prerefunded issues, given their shorter average duration, outperformed other sectors for the month and YTD.

Total Returns of Selected Barclays Municipal Indices and Subsectors

<u>Bloomberg Index/Sector</u>	<u>May</u>	<u>YTD</u>	<u>Duration</u>	<u>Bloomberg Quality</u>	<u>May</u>	<u>YTD</u>	<u>Duration</u>
Municipal Bond Index	0.06%	-0.96%	6.70	AAA	-0.01%	-0.97%	6.84
General Obligation bonds	0.11%	-0.87%	6.33	AA	0.10%	-0.94%	6.59
Revenue bonds	0.03%	-1.04%	6.92	A	0.07%	-0.94%	6.70
Prerefunded bonds	0.82%	1.26%	2.40	BBB	-0.09%	-1.25%	7.52
Long maturities (22+ yrs.)	-0.98%	-3.67%	10.92	High Yield	0.07%	-0.91%	7.46
Intermediate maturities (1 - 17 yrs.)	0.56%	0.33%	4.97	HY, ex-Puerto Rico	0.05%	-0.59%	7.37
Short maturities (1 - 5 yrs.)	0.70%	1.35%	2.30				

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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