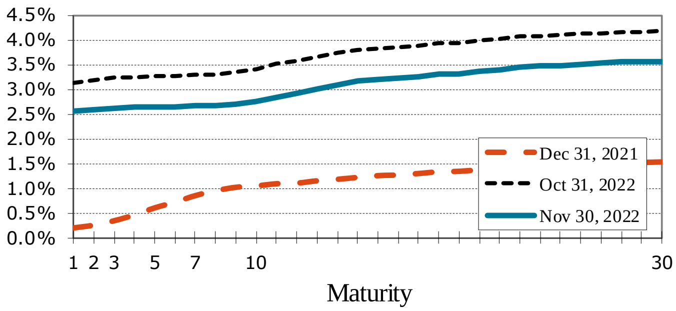
Baird Advisors
Municipal Fixed Income Market Commentary
November 2022

Impressive Decline in Tax-exempt Rates in November

A massive rally occurred in November across the municipal market. Tax-exempt rates fell by approximately 60 bps along the yield curve, reversing roughly one-quarter of the YTD rate rise through October. The market tone was strong throughout the month due to several macro factors, most importantly a firm Treasury market. Inflation slowed in October (CPI of 7.7% YoY down from the June peak of 9.1%) and the Fed signaled a moderation in the pace of rate hikes was likely after four consecutive 75 bps increases, including at the recent November meeting. But what led municipals to handily outperform the Treasury rally this month was an improving supply/demand backdrop for tax-exempt bonds. Although municipal funds continued to experience outflows, the pace slowed and with year-end fast approaching, a dramatic reduction in tax-loss selling pressures is soon expected. That said, YTD net municipal fund redemptions moved further into record territory at $113B. Also supportive of the market was a low level of new supply with November tax-exempt issuance ($24.6B) off 34% from the same month last year, bringing total YTD supply down 6% YoY. Supply is expected to remain light in December and early-January, although the recent rally and stronger market tone could encourage some issuers to accelerate borrowing plans.

AAA Municipal Yields



Maturity	12/31/21	10/31/22	11/30/22	1Mo Δ	YTD Δ
1	0.19%	3.12%	2.56%	-0.56%	2.37%
2	0.25%	3.20%	2.59%	-0.61%	2.34%
3	0.34%	3.23%	2.60%	-0.63%	2.26%
5	0.60%	3.27%	2.65%	-0.62%	2.05%
7	0.85%	3.28%	2.66%	-0.62%	1.81%
10	1.05%	3.40%	2.75%	-0.65%	1.70%
30	1.54%	4.17%	3.57%	-0.60%	2.03%

A Tale of Three Cities: Chicago, Milwaukee and Chester PA

Although the fiscal backdrop for state and local governments remains quite strong, this month illustrated once again the need and benefit of individual credit analysis. In November, Chicago's rating was upgraded to investment grade by Moody's for the first time in over seven years. The new Baa3 rating (from Ba1) highlighted both the steps the city has taken to reduce what Moody's noted as "a massive structural operating deficit," plus steps taken to bring their pension funding to at least a "tread water" status. Yet, Moody's also noted Chicago's "very high leverage and fixed costs," which is why it remains a challenged credit long-term. Just north of Chicago, Moody's downgraded Milwaukee's rating to A3, with a negative outlook, from A2, due to its elevated leverage and rising pension costs. Milwaukee is limited in its revenue-raising ability by the state but, nonetheless, must address its fiscal challenges which "will continue to put downward pressure on the city." Finally, one of the rare city municipal bankruptcies occurred this month when Chester, PA filed for Chapter 9 protection. A city of 32,000 founded in 1682, Chester has long struggled to achieve fiscal balance. Under state oversight since 1995, it was placed in receivership by the state in 2020. Chester has $25 million of total long-term debt outstanding but its much larger issue is an estimated $400 million of unfunded pension and other post-employment liabilities. The sale of its water system is being considered to provide a one-time cash infusion. The takeaway? Regardless of the broad credit backdrop, opportunities and risk always exist among municipal credits.

Significant Rebound in November Reduces the YTD Negative Returns

The sharp decline in municipal rates in November provided the best monthly return for the full Municipal Bond Index since the 1980s. Longer maturities significantly outperformed shorter maturities, although longer issues still materially lag shorter segments YTD. Similarly, both GOs and Revenue bonds outperformed the shorter duration Pre-refunded sector this month. Within the credit spectrum, lower-quality issues outperformed higher-quality issues in November's "risk-on" environment, but higher-quality issues have significantly outperformed lower-quality issues on a YTD basis.

Total Returns of Selected Bloomberg Municipal Indices and Subsectors

Bloomberg Index/Sector	November	YTD	Duration	Bloomberg Quality	November	YTD	*Duration*
Municipal Bond Index	4.68%	-8.79%	*6.17*	AAA	4.58%	-8.10%	*5.96*
General Obligation bonds	4.40%	-8.03%	*5.78*	AA	4.53%	-8.23%	*6.08*
Revenue bonds	4.99%	-9.56%	*6.59*	A	4.82%	-9.46%	*6.29*
Prerefunded bonds	1.94%	-3.06%	*2.39*	BBB	5.66%	-11.67%	*7.13*
Long maturities (22+ yrs.)	7.83%	-15.33%	*10.29*	High Yield	5.82%	-12.96%	*7.80*
Intermediate maturities (1 - 17 yrs.)	3.50%	-6.39%	*4.65*	HY, ex-Puerto Rico	5.52%	-12.71%	*7.66*
Short maturities (1 - 5 yrs.)	1.86%	-3.32%	*2.42*				

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.

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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