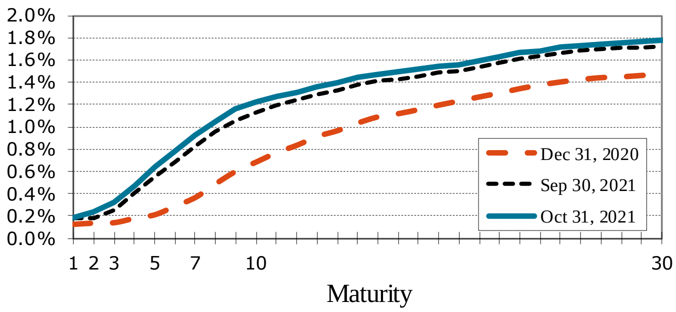
Baird Advisors
Municipal Fixed Income Market Commentary
October 2021

Municipal Yields Rise, Muni Provisions Out of "Build Back Better" Plan

Tax-exempt yields rose modestly in October, led by the intermediate maturity segment where yields rose as much as 10 bps. The rise in intermediate tax-exempt yields, however, was relatively muted when compared to similar-maturity Treasuries that rose twice as much this month. Expectations that the Fed will soon begin tapering asset purchases and the pricing in of two 25bp rate hikes in 2022 were the primary reasons for the upward yield pressure. Also, uncertainty surrounding the size and details of President Biden's Build Back Better plan contributed to market weakness. The framework of the recent plan was cut in half to $1.75 trillion in spending and, at least in its current form, no longer includes any of the favorable municipal provisions proposed in earlier versions. Gone are the headline rate increases in personal and corporate income tax rates, the reinstatement of advance refundings and the reauthorization of a direct-pay taxable bond program (BABs 2.0). Those changes led to a slowing of municipal fund inflows this month although YTD net inflows of $91.4B remain on track to exceed the prior record of $93.6B in 2019. Supply slowed sharply in October from the same month last year (-47%) as both the back up in rates and policy uncertainty slowed issuance. YTD total municipal supply is off 9% YoY, due to the 31% decline in taxable issuance, although tax-exempt supply is up 5%.

AAA Municipal Yields



Maturity	12/31/20	9/30/21	10/31/21	1Mo Δ	YTD Δ
1	0.13%	0.18%	0.19%	0.01%	0.06%
2	0.14%	0.18%	0.23%	0.05%	0.09%
3	0.14%	0.25%	0.32%	0.07%	0.18%
5	0.22%	0.55%	0.64%	0.09%	0.42%
7	0.37%	0.82%	0.92%	0.10%	0.55%
10	0.69%	1.13%	1.22%	0.09%	0.53%
30	1.47%	1.73%	1.77%	0.04%	0.30%

Weakest Cities/States Show Fiscal Improvement; Puerto Rico Prepares to Exit Bankruptcy

Support provided from the massive federal stimulus programs combined with a sharp rebound in tax revenues has lifted the financial profile of nearly all state and local governments, even for some of the more fiscally challenged. For example, the rating on the State of Illinois, which was the only state to borrow from the Fed's Municipal Liquidity Facility in 2020, was recently raised one notch (to Baa2/BBB) with a stable outlook. Similarly, Chicago's rating was confirmed by Fitch this month at BBB, noting the city's nearly $2.4B in federal stimulus funds and tax revenues exceeding expectations. Also, New Jersey (A3/A-), the second lowest-rated state, received $10B in Covid aid and benefited from tax revenues rising 30% YoY in Q3. The state also has $2.4B in rainy day funds and is expecting a surplus of over $2.0B in its current fiscal year. Keeping with this theme, the four year bankruptcy process in Puerto Rico is nearing the end as the PROMESA oversight board reluctantly accepted recently-passed legislation which excludes any pension cuts, paving the way for an approval of the Plan of Adjustment (POA) by the court in early November. Although the island suffered from devastating natural disasters during the oversight period (e.g., hurricanes, earthquakes and Covid-19), the federal support was also massive at over $68B. In addition, through the bankruptcy process Puerto Rico was able to reduce total projected debt service from $90B to roughly $34B – a 62% decrease – which offers the Commonwealth a chance for financial stability. Each of the above perennially-challenged credits has taken steps, with strong federal support, to shore up their respective fiscal positions, but they will need to remain focused on addressing long-term financial challenges.

Upward Rate Movements Push October Returns Negative

Higher rates in October led to modestly negative returns for the month although the short-term segment of the curve outperformed intermediate and longer maturities. Higher-quality outperformed lower-quality last month as credit spreads widened slightly. Prerefunded issues held their value best relative to other sectors due to their shorter average maturity.

Total Returns of Selected Bloomberg Municipal Indices and Subsectors

Bloomberg Index/Sector	October	YTD	Bloomberg Quality	October	YTD
Municipal Bond Index	-0.29%	0.50%	AAA	-0.18%	-0.53%
General Obligation bonds	-0.27%	0.03%	AA	-0.24%	-0.01%
Revenue bonds	-0.31%	0.75%	A	-0.39%	1.16%
Prerefunded bonds	-0.15%	-0.10%	BBB	-0.51%	3.49%
Long maturities (22+ yrs.)	-0.29%	1.28%	High Yield	-0.41%	6.10%
Intermediate maturities (1 - 17 yrs.)	-0.29%	0.19%	HY, ex-Puerto Rico	-0.32%	6.27%
Short maturities (1 - 5 yrs.)	-0.14%	0.27%			

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.

RB2021-0805

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.