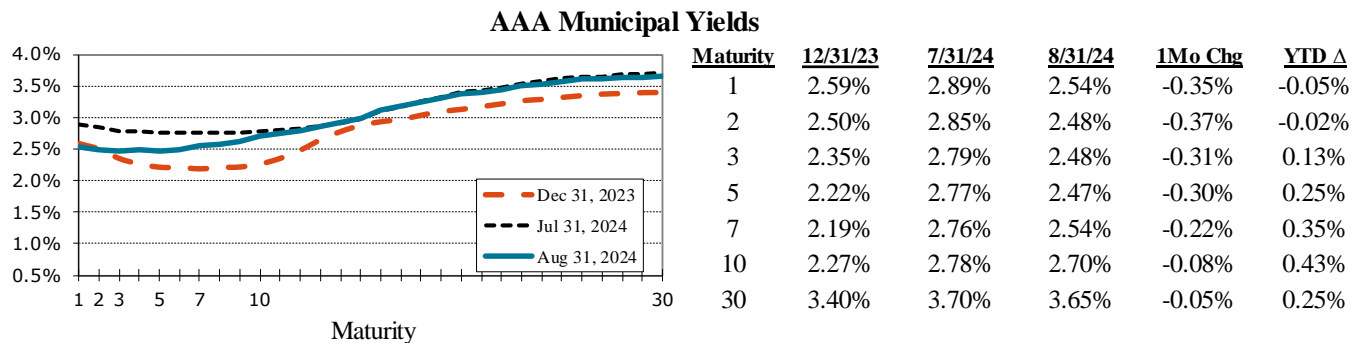


Baird Advisors
Municipal Fixed Income Market Commentary
August 2024

Municipal Curve Returns to Positive Slope

Tax-exempt yields fell in August for the third consecutive month, led by the short end of the curve. The 2yr yield fell 37 bps while the 10yr yield fell 8 bps, returning the 2s10s curve back to a positive posture after 18 months of an inverted slope. Helping to fuel the strong front-end rally was confirmation from Fed Chair Powell of the intention to cut interest rates at the September FOMC meeting; market consensus expects a total of 100 bps of cuts by year end. Demand for municipals was strong in August, helped by positive mutual fund flows which brought the YTD total to \$20B. The favorable fund flows were, in part, driven by \$60B in August reinvestment needs from early-calls and maturities, which helped absorb a robust new issue calendar. Total issuance in August was \$49B, bringing the YTD total to \$329B, \$88B ahead of the 2023 pace. Supply may slow surrounding the election and Fed meeting in early-November, but we expect it to resume quickly and at a robust pace into year-end. The rate backdrop is favorable and infrastructure activity is increasing around the country (see below).



Other Market and Credit News

- The municipal market noted Vice-President Kamala Harris's endorsement of the proposed tax increases in President Biden's most recent budget proposal. While no meaningful tax discussions will occur until well after the election, the potential for higher federal tax rates is drawing the attention of investors. If the Biden/Harris budget rates were enacted, the top marginal tax rate for individuals would rise to 44.6% from 40.8%, combining the top individual rate of 39.6% (from 37.0%) with a Medicare surtax of 5% (from 3.8%).
- BofA Global Research noted that the municipal market has had the longest stretch without a bankruptcy filing (over 15 months) since at least July 1987. The massive federal pandemic-era aid has clearly contributed to this favorable streak, but fiscal conditions are gradually normalizing. The upgrade/downgrade ratings ratio was a still favorable 1.7 to 1 in Q2, when Moody's and S&P ratings are combined, but has been trending down in recent quarters. And technical, if not actual payment, defaults are still occurring. In August, a small Texas municipality (Clyde – part of the Abilene MSA) blamed drought conditions on a payment default due to insufficient water revenues. No bondholders were impaired since all the city debt was insured but it is a reminder that even with a strong credit backdrop solid fundamental research remains critically important.
- The July Dodge Construction Network report showed a notable increase in nonbuilding groundbreakings, which includes highway and bridge work. Now that interest rates have stabilized, public works spending is increasing, in part because of the boost from the 2021 Infrastructure and Jobs Act. This has contributed to the sizeable boost in municipal supply YTD.

Positive Returns for August

Continued falling yields in August produced a third consecutive month of positive returns across the municipal market. Short-term maturities outperformed longer segments of the curve and GO bonds outperformed Revenue bonds this month. However, Revenue bonds are still outperforming GOs YTD. Returns by quality were similar this month, but the HY index is still besting the investment grade category returns YTD.

Total Returns of Selected Barclays Municipal Indices and Subsectors

<u>Bloomberg Index/Sector</u>	<u>August</u>	<u>YTD</u>	<u>Duration</u>	<u>Bloomberg Quality</u>	<u>August</u>	<u>YTD</u>	<u>Duration</u>
Municipal Bond Index	0.79%	1.30%	6.18	AAA	0.85%	0.65%	6.47
General Obligation bonds	0.87%	0.80%	5.88	AA	0.75%	1.01%	6.05
Revenue bonds	0.75%	1.46%	6.38	A	0.72%	1.98%	6.03
Prerefunded bonds	0.89%	2.05%	2.33	BBB	0.91%	3.22%	7.10
Long maturities (22+ yrs.)	0.66%	1.71%	9.86	High Yield	1.18%	6.52%	6.62
Intermediate maturities (1 - 17 yrs.)	0.88%	1.13%	4.69	HY, ex-Puerto Rico	1.27%	6.98%	6.52
Short maturities (1 - 5 yrs.)	0.95%	1.96%	2.34				

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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