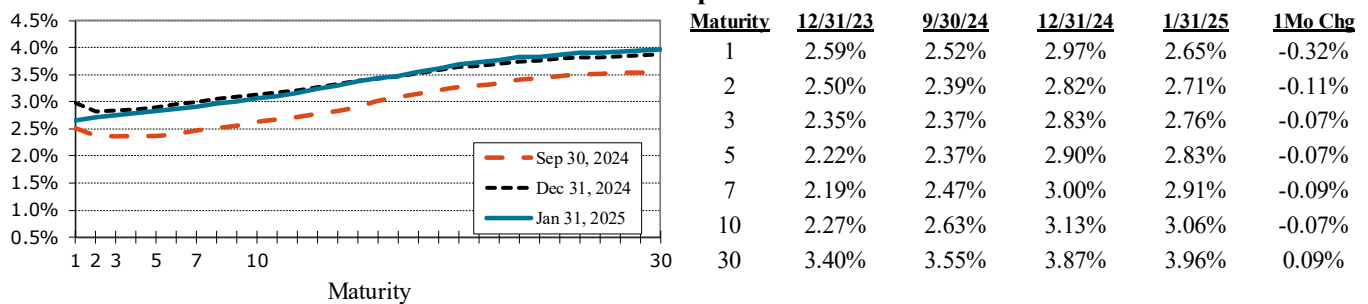


Baird Advisors
Municipal Fixed Income Market Commentary
January 2025

Curve Steepens and Tax-exempt Yields Fall Despite Strong January Supply

Tax-exempt yields fell to start the year. Short-term yields declined the most, steepening the curve as 1yr rates fell 32 bps, the 10yr eased 7 bps and the 30yr yield *rose* 9 bps. The 2s10s AAA curve slope continued to normalize in January finishing the month at a positive 35 bps, +4bps from year end. Demand for municipals was strong, evidenced by \$3.4B of net inflows to tax-free funds/ETFs. Notably, short-term municipal funds, which experienced outflows in 2024, received inflows as well – something we anticipated would happen. With the curve returning to a positive slope, investors are incentivized to extend from cash equivalents and money market funds out to longer maturities. The market also benefited from roughly \$40B of principal and interest payments on existing municipal debt in January, a strong reinvestment month. Fortunately, new issuance was also robust, setting a January record of \$37B in new municipal supply, up 19% from the same month last year. Perhaps helping to boost supply is the desire of issuers to pull forward supply prior to any potential tax policy changes.

AAA Municipal Yields



California Wildfire Update

In what is being described as the most destructive wildfires in California's history, more than 50,000 acres were burned, including an estimated 17,000 structures, and insured losses are projected to reach \$30B. The fires are tragic from both a human and property perspective, and it will take years before the hardest hit communities fully recover. However, for context, the damaged areas represent just 2% of the vast L.A. County landmass. We have no direct exposure in our portfolios to the heavily damaged areas and we do not anticipate defaults on any general obligation debt in the county. Tax values will clearly be negatively impacted for some time, particularly given the magnitude of homes and structures damaged or destroyed, but land values still represent the majority of the tax base. Since the passage of Proposition 13 in 1978, annual increases to property tax values have been capped at 2% (assuming a property was sold), which has kept assessed valuations below market value for many areas. In addition, the pre-fire strength of these credits along with anticipated state and federal aid, should prevent material credit deterioration because of the fires. However, S&P did downgrade the rating of the Los Angeles Department of Water and Power Authority (LADWP) two notches (to A from AA-) and other rating agencies moved it to a Negative Outlook due to potential litigation risk, even though no direct blame for the cause of the fires has been assigned. Not surprisingly, however, credit spreads on LADWP bonds widened during the month as selling pressure emerged. That said, Fitch noted in their credit evaluation that LADWP is the largest municipal utility in the U.S, providing retail electric and water services to approximately four million residents – including 1.6 million water connections and 700,000 electric. The service territory is vast, covering 470 square miles of the city's total 503 square miles. So, while the territory affected by the fires is significant in size, the ability to distribute risk and any necessary rate adjustments across its full customer base is a strong factor in analyzing the LADWP credit.

Positive Returns to Start 2025

January returns were positive to start the year as yields fell across most of the curve. Although short rates fell the most, the intermediate part of the curve performed the best. The shorter average maturity of the Pre-refunded sector outperformed both the GO and Revenue bond sectors. Across the quality spectrum, BBB-rated bonds continued their outperformance relative to higher quality debt and High Yield municipals also continued the 2024 trend of outperforming investment grade issues.

Total Returns of Selected Barclays Municipal Indices and Subsectors

<u>Bloomberg Index/Sector</u>	<u>2024</u>	<u>January</u>	<u>Duration</u>	<u>Bloomberg Quality</u>	<u>2024</u>	<u>January</u>	<u>Duration</u>
Municipal Bond Index	1.05%	0.50%	6.28	AAA	0.33%	0.56%	6.43
General Obligation bonds	0.55%	0.46%	5.93	AA	0.79%	0.41%	6.12
Revenue bonds	1.22%	0.51%	6.49	A	1.78%	0.61%	6.30
Prerefunded bonds	2.08%	0.65%	2.45	BBB	2.87%	0.80%	7.22
Long maturities (22+ yrs.)	1.40%	0.08%	9.93	High Yield	6.32%	0.76%	6.76
Intermediate maturities (1 - 17 yrs.)	0.88%	0.68%	4.79	HY, ex-Puerto Rico	6.78%	0.71%	6.70
Short maturities (1 - 5 yrs.)	2.07%	0.54%	2.35				

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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