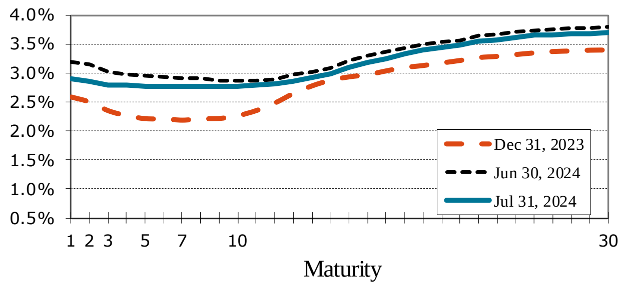
Baird Advisors
Municipal Fixed Income Market Commentary
July 2024

Municipal Yields Fall in July on Strong Demand and Still Robust Supply

Tax-exempt yields fell in July with rates on the shortest maturities falling the most (-31bps). The 10yr AAA yield fell 8 bps, ending the month at 2.78%. The front-end rally helped to narrow the gap in the 2s10s curve inversion to -7 bps from -28 bps at the end of Q2. Softer inflation data and signals from the Fed that a September rate cut was likely helped to push yields lower. Municipal funds had net inflows of $4B in July which brings the YTD total to $15.6B. In addition, investors had an estimated $50B of cash flow from maturities, calls and interest payments in July, fueling demand, with another $60B expected in August, the heaviest reinvestment month of the year. New supply in July was also robust, with $36B of issuance. While this was lower than the robust $42B monthly average of the second quarter it was still up 50% relative to July 2023. Total issuance YTD of $279B is the highest level in at least the last ten years. We would expect supply to slow somewhat into the November election, but municipalities still have pent up capex needs and lower rates should continue to encourage refunding activity.

AAA Municipal Yields



Maturity	12/31/23	3/31/24	6/30/24	7/31/24	1Mo Chg	YTD Δ
1	2.59%	3.21%	3.20%	2.89%	-0.31%	0.30%
2	2.50%	2.99%	3.14%	2.85%	-0.29%	0.35%
3	2.35%	2.81%	3.02%	2.79%	-0.23%	0.44%
5	2.22%	2.52%	2.96%	2.77%	-0.19%	0.55%
7	2.19%	2.48%	2.92%	2.76%	-0.16%	0.57%
10	2.27%	2.52%	2.86%	2.78%	-0.08%	0.51%
30	3.40%	3.73%	3.79%	3.70%	-0.09%	0.30%

Energy in Demand

The public power sector has historically been a small, but key component of electricity generation in the U.S. for many years, producing approximately 15% of total electricity generation, much less than the 72% of power provided by investor-owned (IO) utilities. Public power entities, however, far outnumber IO providers, with nearly 2,000 utilities across the country (59% of the total number) with the median municipal utility serving about 4,400 people. Not surprisingly, public electric utility debt also represents a relatively small portion of outstanding municipal debt, holding near 5% for many years given the lack of growth in electricity demand and modest issuance over the last decade. But the outlook for both electricity demand and debt issuance is changing. Electricity demand in the U.S. is expected to grow rapidly over the next several years, driven by the expansion of AI data centers and the planned increase of electric vehicles on the road. Power generation from public utilities benefits from a variety of sources, including natural gas (44%), coal (21%) and the 35% balance from several non-carbon emitting sources, particularly hydro. The municipal utility sector is also highly rated. Nearly all the entities that carry debt have an investment grade rating with the average rating in the "AA" category. Yet, it is not a sector without risk as witnessed by the freezing of the electric utility grid in Texas in 2021 from Winter Storm Uri, which caused massive outages, the excess costs of which were ultimately reimbursed through debt funding. Wildfire risk is also a prominent risk, particularly out west (and in Hawaii). Yet, regulators in most states understand the need to maintain financially strong utilities that can provide reliable power to meet the growing demand. We expect to see greater debt issuance from public power providers over the next several years to help fund aging infrastructure needs to operate both safely and efficiently. So far in 2024, municipal utilities have issued approximately $60B of debt, the fastest YTD pace in the past 10 years. We anticipate there will be many opportunities for municipal investors to add high quality municipal utility debt to their portfolios over the next several quarters to help fund the growing demand for power in the U.S.

Positive Returns for July

Falling yields in July produced positive returns across the municipal market. Long-term maturities marginally outperformed shorter segments of the curve, but there was little differentiation between GOs and Revenues bonds this month. Pre-refunded bonds lagged in July but remain the best performing sector YTD. Lower-quality bonds continue to outperform for the month and YTD.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	July	YTD	*Duration*	Bloomberg Quality	July	YTD	*Duration*
Municipal Bond Index	0.91%	0.50%	*6.04*	AAA	0.90%	-0.20%	*6.31*
General Obligation bonds	0.93%	-0.07%	*5.71*	AA	0.90%	0.22%	*5.92*
Revenue bonds	0.91%	0.70%	*6.28*	A	0.92%	1.25%	*5.91*
Prerefunded bonds	0.75%	1.16%	*2.16*	BBB	0.99%	2.29%	*7.00*
Long maturities (22+ yrs.)	0.97%	1.05%	*9.68*	High Yield	1.10%	5.28%	*6.57*
Intermediate maturities (1 - 17 yrs.)	0.89%	0.25%	*4.61*	HY, ex-Puerto Rico	1.11%	5.64%	*6.47*
Short maturities (1 - 5 yrs.)	0.84%	1.00%	*2.32*				

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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