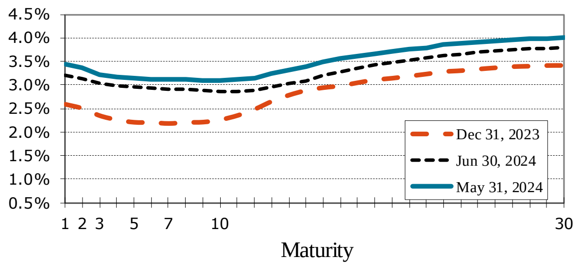
Baird Advisors
Municipal Fixed Income Market Commentary
June 2024

Municipal Yields Fall in June, Rise in Q2 and Supply Booms

Tax-exempt yields fell in June in a near parallel manner across the curve, but the decline was insufficient to offset increases in the prior two months, leaving yields higher for the quarter. The sharpest yield increases in Q2 occurred among intermediate maturities (5yr and 7yr yields each rose 44 bps) which helped to not only partially reverse the curve's inversion but to also improve tax-exempt valuations relative to Treasuries. For example, the 5yr and 10yr Municipal/Treasury yield ratios rose to 69% and 67%, respectively, at the end of June, up from 60% for each in March. The yield inversion between the 2-10yr segment of the municipal curve narrowed, ending Q2 at -28 bps, down from -53 bps at the end of the prior quarter. Helping to push municipal rates higher in Q2 was heavy municipal supply. Total municipal supply (tax-exempt and taxable) in Q2 was up 39% YoY while tax-exempt issuance alone of $220B YTD through June was 43% ahead of last year's pace and the strongest first-half issuance in at least ten years. With the higher-than-expected supply, dealers boosted their full-year issuance expectations to roughly $450B, up more than 10% from the start of the year. Fortunately, demand for municipals was equally robust as seasonal support from the heavy reinvestment of bond maturities and early calls helped to match supply. Beyond this, flows into municipal funds remained positive in Q2, bringing the YTD total to $11.4B.

AAA Municipal Yields



Maturity	12/31/23	3/31/24	5/31/24	6/30/24	1Mo Chg	Q2 Δ	YTD Δ
1	2.59%	3.21%	3.43%	3.20%	-0.23%	-0.01%	0.61%
2	2.50%	2.99%	3.36%	3.14%	-0.22%	0.15%	0.64%
3	2.35%	2.81%	3.23%	3.02%	-0.21%	0.21%	0.67%
5	2.22%	2.52%	3.14%	2.96%	-0.18%	0.44%	0.74%
7	2.19%	2.48%	3.11%	2.92%	-0.19%	0.44%	0.73%
10	2.27%	2.52%	3.11%	2.86%	-0.25%	0.34%	0.59%
30	3.40%	3.73%	4.00%	3.79%	-0.21%	0.06%	0.39%

PREPA Ruling Offers Clarity on Revenue Bond Security

Broadly classified, Revenue bonds are the largest sector of the municipal market, representing 60% - 70% of most municipal indices. Revenue bond sub-sectors include, among others, water and sewer authorities, hospitals, housing, transportation and sales tax issues. Revenue bonds provide an identifiable revenue stream that can be monitored to assure ample debt service coverage. A recent ruling related to the Puerto Rico bankruptcy helped to confirm the strong legal support that many Revenue bonds offer, but, nonetheless, also highlights the inherent risks of a struggling municipality. In June, the US First Circuit Court of Appeals reversed a lower court finding that attempted to restrict bondholders' claim on the electric revenues of the Puerto Rico Electric Power Authority (PREPA). The First Circuit confirmed that PREPA bondholders had a right to both current and future revenues (as expected) and the claim existed even without bond documents explicitly using the legal term "lien" on the claim. The PREPA case was closely watched by municipal investors as the bondholder claim on revenues is a key metric for investing. Although specific to the PREPA case, municipal investors took comfort in the broader implications for Revenue bonds stemming from the First Circuit decision. Fortunately, municipal bankruptcies are rare, but one favorable aspect is they help clarify investor claims and the priority of payments. For example, the Detroit bankruptcy of 2013 highlighted that not all General Obligation (GO) debt has an equal claim on tax revenues; GO debt that was voter-approved and backed by a dedicated property tax was treated better than other GO debt. Also, in Detroit, pension benefits were given priority over all GO debt holders. Overall, the main takeaway from these rulings is the clarification on Revenue bond security. While the First Circuit decision offers broad support for the sector, it does not dismiss the need for fundamental research and the ongoing monitoring of credits. In all cases, economic considerations and realities are factors that will determine the probability of debt repayment.

Positive Returns for June, Mixed for the Quarter

The decline in yields across the curve in June produced broadly positive returns for the month and improved YTD returns. The broad municipal index has returned -0.40% YTD, up from -1.91% at the end of May. Revenue bonds outperformed other sectors, while Pre-refunded bonds still lead YTD. Lower-quality bonds continue to outperform for the month and YTD.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	June	Q2	YTD	*Duration*	Bloomberg Quality	June	Q2	YTD	*Duration*
Municipal Bond Index	1.53%	-0.02%	-0.40%	*6.02*	AAA	1.60%	-0.28%	-1.09%	*6.27*
General Obligation bonds	1.39%	-0.30%	-0.99%	*5.71*	AA	1.48%	-0.11%	-0.68%	*5.90*
Revenue bonds	1.62%	0.07%	-0.20%	*6.25*	A	1.52%	0.22%	0.33%	*5.87*
Prerefunded bonds	0.69%	0.50%	0.40%	*2.13*	BBB	1.97%	0.68%	1.29%	*7.09*
Long maturities (22+ yrs.)	2.10%	0.83%	0.08%	*9.66*	High Yield	2.45%	2.59%	4.14%	*6.61*
Intermediate maturities (1 - 17 yrs.)	1.29%	-0.34%	-0.63%	*4.57*	HY, ex-Puerto Rico	2.83%	3.06%	4.48%	*6.53*
Short maturities (1 - 5 yrs.)	0.78%	0.35%	0.16%	*2.30*					

<u>Disclosures</u>

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.

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