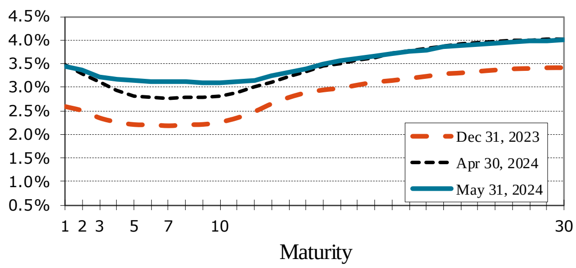
Baird Advisors
Municipal Fixed Income Market Commentary
May 2024

Municipal Yields Mixed in May on Supply Surge

Tax-exempt yields were mixed in May, with yields in the five to ten-year segment of the curve rising as much as 34 bps, while the shortest and longest maturities experienced modest yield declines. The rise in intermediate rates helped to reduce the 1s10s curve inversion, which narrowed to -32 bps from -69 bps at the end of March. Heavy supply was the primary reason that municipal yields rose even as Treasury yields fell. The divergence between the two markets helped to improve the relative valuation of municipals to Treasuries. For example, the Municipal/Treasury yield relationship cheapened in 5yr and 10yr maturities, with intermediate AAA municipals rising to 70% of comparable maturity Treasuries, up from 60% at quarter end. A total of $47B of municipal debt was issued in May, up 64% from May 2023. YTD tax-exempt issuance of $176B is up $56B YoY (+46%) while taxable municipal issuance is unchanged. The boost in tax-exempt supply was caused by several factors, including pent up capex needs, fading pandemic support and an unexpected surge in refundings, specifically the refinancing of taxable Build America Bonds (BABs). The catalyst for the BAB refundings is a legal opinion that sequestration (which was an across-the-board reduction in federal spending – including BAB interest subsidies) resulted in a “materially adverse change” to BABs, allowing extraordinary redemption call features to be exercised and the debt refunded with new, lower-cost, tax-exempt bonds. On the demand side, positive fund flows continued in May as net inflows of over $900 million this month lifted the YTD total to $10.5B.

AAA Municipal Yields



Maturity	12/31/23	3/31/24	4/30/24	5/31/24	1Mo Chg	QTD Chg	YTD Chg
1	2.59%	3.21%	3.49%	3.43%	-0.06%	0.22%	0.84%
2	2.50%	2.99%	3.28%	3.36%	0.08%	0.37%	0.86%
3	2.35%	2.81%	3.10%	3.23%	0.13%	0.42%	0.88%
5	2.22%	2.52%	2.81%	3.14%	0.33%	0.62%	0.92%
7	2.19%	2.48%	2.77%	3.11%	0.34%	0.63%	0.92%
10	2.27%	2.52%	2.80%	3.11%	0.31%	0.59%	0.84%
30	3.40%	3.73%	4.02%	4.00%	-0.02%	0.27%	0.60%

Secular Changes Impacting Higher Education Sector

Higher Education was undergoing significant changes, even before the Covid pandemic arrived in 2020. Well before that, competition for students had been intense for years. According to the annual State of Higher Education Finance Report, national enrollment declined by 0.5% in 2023, the 12th straight year of declines. Filling classroom seats and dorm rooms will only grow more challenging as the number of high school graduates peaks in 2025-26. Tuition discounting is one of the challenges. A 2023 National Association of College and University Business Officers (NACUBO) survey of 325 private, non-profit institutions found an average tuition discount of 56.1% for incoming freshman and 51.9% for all undergraduates, new highs for each measure. Stagnant revenues and rising expenses pressure operating deficits, often leading to a greater draw of reserves than planned. Not all schools are impacted equally, of course, as larger, public universities and elite private schools will remain strong. But smaller, private schools, without an education niche or sizable endowment are likely to struggle in this evolving landscape. Colleges and universities realize the need to stay competitive and appealing to attract students. As such, they are increasingly turning to the municipal market to fund deferred maintenance needs, upgrade student housing and add/expand athletic or other facilities. Higher Ed municipal borrowings of approximately $15B YTD already exceed the total issued for all of 2023, with more expected. While careful credit analysis is always necessary, it remains a highly rated sector with significant opportunities for investment. Of the 447 colleges/universities rated by S&P, 93% currently carry an investment grade rating and over 60% are rated A or higher. Although many lower-rated issues carry negative outlooks there are opportunities to be found amid the turmoil.

Modestly Negative Returns for May

Given the relative stability in long-term yields in May, the longest maturity segment had a positive return, outperforming both short and intermediate segments. Pre-refunded bonds outperformed other sectors, maintaining their YTD lead over both GOs and Revenue issues. Lower-quality bonds, particularly BBB and High Yield debt, outperformed higher-quality issues in May.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	May	YTD	*Duration*
Municipal Bond Index	-0.29%	-1.91%	*6.10*
General Obligation bonds	-0.41%	-2.35%	*5.81*
Revenue bonds	-0.26%	-1.79%	*6.35*
Prerefunded bonds	-0.05%	-0.29%	*2.04*
Long maturities (22+ yrs.)	0.46%	-1.98%	*9.85*
Intermediate maturities (1 - 17 yrs.)	-0.59%	-1.90%	*4.61*
Short maturities (1 - 5 yrs.)	-0.08%	-0.62%	*2.27*

Bloomberg Quality	May	YTD	*Duration*
AAA	-0.49%	-2.64%	*6.37*
AA	-0.36%	-2.12%	*5.99*
A	-0.10%	-1.17%	*5.96*
BBB	0.14%	-0.67%	*7.10*
High Yield	0.76%	1.65%	*6.91*
HY, ex-Puerto Rico	0.78%	1.61%	*6.92*

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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