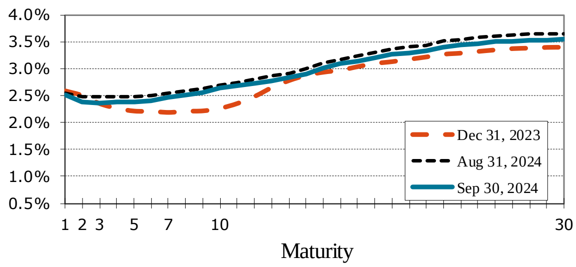
Baird Advisors
Municipal Fixed Income Market Commentary
September 2024

Municipal Yields Fall through Q3 Even as Supply Soars

Tax-exempt yields fell in September and in 3Q but intermediate and long yields remain higher than the start of the year. Short-term municipal yields fell more than long-term rates in Q3, thanks to a 50 bp easing by the Fed in September, which helped to un-invert the municipal curve. For the quarter, 2yr and 10yr yields fell by 75 bps and 23 bps, respectively, leaving the 2s10s curve segment with a positive slope of +24 bps; a long way from the maximum inversion point of -50 bps in April. Demand for municipals was steady in the quarter, with $13B of net mutual fund and ETF inflows, bringing the YTD total to $25B. A number of factors are driving the demand for municipals, including positive real yields now available when viewed on a tax-equivalent basis, emerging roll-down benefits as the curve normalizes, and the possibility of higher tax rates when the 2017 Tax Cuts and Jobs Act expires next year. Supply was also robust as $126B of tax-exempt debt was issued in Q3 which boosted the YTD total to $346B. Along with the important presidential and congressional elections in November, there are also $70B worth of bond referendums for voters to consider, among the highest in the last ten years. In addition, there are eleven gubernatorial elections, with Republicans currently holding eight of those spots, which could sway the balance of power in various locations.

AAA Municipal Yields



Maturity	12/31/23	6/30/24	8/31/24	9/30/24	1Mo Chg	Q3 Δ	YTD Δ
1	2.59%	3.20%	2.54%	2.52%	-0.02%	-0.68%	-0.07%
2	2.50%	3.14%	2.48%	2.39%	-0.09%	-0.75%	-0.11%
3	2.35%	3.02%	2.48%	2.37%	-0.11%	-0.65%	0.02%
5	2.22%	2.96%	2.47%	2.37%	-0.10%	-0.59%	0.15%
7	2.19%	2.92%	2.54%	2.47%	-0.07%	-0.45%	0.28%
10	2.27%	2.86%	2.70%	2.63%	-0.07%	-0.23%	0.36%
30	3.40%	3.79%	3.65%	3.55%	-0.10%	-0.24%	0.15%

Up-In-Quality Opportunity in Texas PSF School Debt

Lower-quality credits have outperformed AAA rated issues YTD due to both a strong fundamental and supply/demand (technical) backdrop. These conditions have helped narrow the yields at which lower-quality credits trade relative to higher-quality. Therefore, better value is currently available, broadly speaking, among higher-quality issues. Fortunately, there are many higher-quality issuers in the municipal market. One of the stronger and currently more appealing is Texas school district bonds backed by the Aaa/AAA rated Permanent School Fund (PSF). The PSF was established in 1983 to help lower the cost of debt for qualifying school districts by offering its guarantee for the timely payment of principal and interest. As of FY24, the PSF held $60B of assets which backstops $126B of school debt. Most Texas school districts are strong credits on their own, with growing enrollment and rising property values, and were made even stronger by the significant federal support school districts across the country received from the Elementary and Secondary School Emergency Relief (ESSER) program during COVID-19. Historically, Texas school debt guaranteed by the PSF has never defaulted, but if that were to happen, the Fund has the authority to intercept state funds to the district to recapture any losses. Helping to preserve the AAA rating is the cap on the amount of debt the PSF can guarantee, which is limited both by the state ($153B) and the IRS ($219B). What makes PSF-backed debt particularly appealing now is the heavy Texas issuance this year. According to Bloomberg, only California has issued more debt YTD ($61B) than Texas ($57B). A sizable portion of the strong Texas issuance has been for school districts. As a result, PSF-backed Texas school debt yields are currently more closely aligned with lower-rated debt in other states, creating an opportunity for investors to maintain a higher-quality focus while also capturing relative value in the market.

Positive Returns for Q3

Falling yields produced a positive quarterly return, adding to the already positive YTD results. Long-term maturities outperformed shorter segments of the curve in Q3 as duration risk was rewarded. There was little difference in performance across the sectors in the quarter, but GOs are lagging YTD. For the quarter, lower-quality bonds slightly outperformed higher-quality, but YTD BBBs and High Yield municipals have vastly outperformed higher-quality issues.

Total Returns of Selected Barclays Municipal Indices and Subsectors

Bloomberg Index/Sector	September	Q3	YTD	*Duration*	Bloomberg Quality	September	Q3	YTD	*Duration*
Municipal Bond Index	0.99%	2.71%	2.30%	*6.12*	AAA	1.01%	2.79%	1.67%	*6.38*
General Obligation bonds	0.94%	2.77%	1.75%	*5.85*	AA	0.97%	2.69%	1.99%	*6.00*
Revenue bonds	1.02%	2.70%	2.50%	*6.32*	A	1.01%	2.67%	3.01%	*6.00*
Prerefunded bonds	0.51%	2.16%	2.57%	*2.39*	BBB	0.99%	2.91%	4.24%	*7.03*
Long maturities (22+ yrs.)	1.38%	3.03%	3.11%	*9.71*	High Yield	0.90%	3.21%	7.48%	*6.54*
Intermediate maturities (1 - 17 yrs.)	0.82%	2.61%	1.96%	*4.67*	HY, ex-Puerto Rico	0.90%	3.30%	7.93%	*6.45*
Short maturities (1 - 5 yrs.)	0.51%	2.31%	2.47%	*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.

Robert W. Baird & Co. Incorporated.

This is not a complete analysis of every material fact regarding any company, industry or security. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy. Indices are unmanaged and are not available for direct investment.