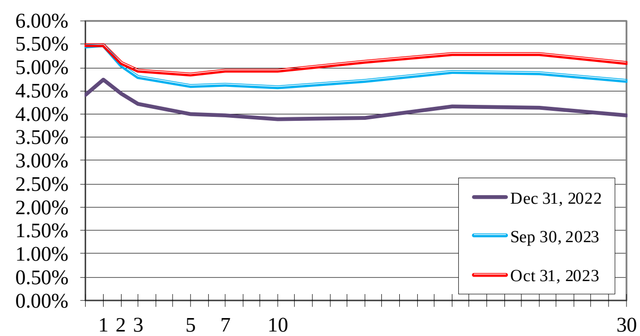
Baird Advisors
Fixed Income Market Commentary
October 2023

Trend of Rising Yields Continues as Inflation Remains Above Target and Term Premium Rises

The 10yr Treasury yield continued its march higher and hit a cycle peak of 5.02% mid-month before ultimately ending October at 4.93%, 36 bps higher for the month. Yield increases were greatest for longer maturities, indicative of a rising term premium, as the curve bear-steepened for a second straight month. The slope of 2s/10s ended October at -16 bps, its least inverted level since September of 2022. The rise in yields was again driven by a robust labor market, sticky inflation and better than anticipated economic growth. September payrolls of +336k jobs was well above the 170k estimate and included prior upward revisions. Headline inflation (CPI) remained at 3.7% YoY, above the 3.6% estimate and the Fed's 2% target. GDP also surprised to the upside at 4.9% vs. a 4.5% estimate and Q3 earnings from US corporations were above expectations. Tighter policy was evident as existing home sales sank to 2010 levels. Sales declined as 30yr mortgage rates near 7.80% hurt affordability and deterred sellers that had previously "locked in" fixed rate mortgages at substantially lower rates. Mike Johnson (R-LA) was elected as House Speaker, along party lines. Focus then turned toward a potential continuing resolution before November 17 to avert a government shutdown and address the Federal budget deficit, cited as another driver of rising term premiums. Hamas' attack in Israel added to geopolitical risks and Treasury volatility in October. Congressional funding for the conflicts in Ukraine and Israel will be debated in the weeks ahead.

Treasury Yields



Maturity	12/31/22	9/30/23	10/31/23	1 Mo Chg	YTD Chg
3 Mo	4.41%	5.46%	5.48%	0.02%	1.07%
1	4.73%	5.48%	5.47%	-0.01%	0.74%
2	4.43%	5.05%	5.09%	0.04%	0.66%
3	4.23%	4.81%	4.93%	0.12%	0.70%
5	4.01%	4.61%	4.86%	0.25%	0.85%
7	3.97%	4.62%	4.94%	0.32%	0.97%
10	3.88%	4.57%	4.93%	0.36%	1.05%
20	4.15%	4.90%	5.29%	0.39%	1.14%
30	3.97%	4.70%	5.10%	0.40%	1.13%

Spreads Widen in October

US Agency RMBS spreads widened +9 bps in October and ended the month at 75 bps, just below the YTD wide achieved mid-month (82 bps). Non-Agy CMBS widened +13 bps and is now +37 bps wider YTD, driven by outsized widening of lower rated subordinate classes. IG Corporate spreads ended October at 129 bps, +8 bps for the month and -1 bps YTD. US HY Corporate debt widened most, +43 bps in October, but remains -32 bps tighter year to date.

Returns Negative Across the Board in October

The US Agg Index declined -1.58% in October, taking YTD returns to -2.77%. Agy RMBS posted the largest declines among IG sectors according to both nominal (-2.07%) and excess returns (-0.64%). Higher rates, higher volatility and a reduction in demand from the Fed and banks has weighed on Agy RMBS returns. CMBS declined -0.89% in October. IG Corporates returned -1.87% and wider spreads led to negative excess returns (-0.34%) in October but excess returns remain positive YTD (+1.99%).

Option-Adjusted Spreads (in bps)

	12/31/22	9/30/23	10/31/23	1Mo Chg	YTD Chg
U.S. Aggregate Index	51	52	57	5	6
U.S. Agency (non-mortgage)	26	16	16	0	-10
Mortgage and ABS Sectors					
U.S. Agency RMBS (Pass-throughs)	51	66	75	9	24
U.S. Agency CMBS	52	54	61	7	9
U.S. Non-Agency CMBS	179	203	216	13	37
Asset-Backed Securities	76	67	79	12	3
Corporate Sectors					
U.S. Investment Grade	130	121	129	8	-1
Industrial	125	110	116	6	-9
Utility	129	122	129	7	0
Financial Institutions	140	140	152	12	12
Non-Corporate Credit	66	56	57	1	-9
U.S. High Yield Corporates	469	394	437	43	-32
Emerging Market Debt	687	648	676	28	-11

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total Return	MTD Excess Return	3 Mo Total Return	3 Mo Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	-1.58%	-0.27%	-4.69%	-0.56%	-2.77%	0.23%	6.04
U.S. Gov't/Credit Index	-1.42%	-0.13%	-4.30%	-0.13%	-2.26%	0.78%	5.95
U.S. Intermediate Gov't/Credit Index	-0.46%	-0.10%	-1.55%	-0.23%	0.19%	0.34%	3.73
U.S. 1-3 Yr. Gov't/Credit Index	0.31%	-0.04%	0.62%	-0.11%	2.19%	0.07%	1.84
U.S. Treasury	-1.21%	0.00%	-3.89%	0.00%	-2.71%	0.00%	5.70
U.S. Agency (Non-Mortgage)	-0.17%	-0.03%	-0.58%	0.11%	1.23%	0.46%	3.09
U.S. Agency RMBS (Pass-Throughs)	-2.07%	-0.64%	-5.97%	-1.73%	-4.28%	-1.20%	6.45
CMBS (Commercial Mortgage Backed Securities)	-0.89%	-0.33%	-2.11%	-0.19%	-0.72%	0.12%	4.32
ABS (Asset-Backed Securities)	-0.16%	-0.21%	-0.34%	-0.16%	1.82%	0.62%	2.54
U.S. Corporate Investment Grade	-1.87%	-0.34%	-5.23%	-0.35%	-1.86%	1.99%	6.56
U.S. High Yield Corporates	-1.16%	-0.92%	-2.06%	-1.11%	4.63%	4.18%	3.55
Emerging Market Debt	-0.88%	0.31%	-3.98%	-0.85%	2.18%	4.15%	4.59
Municipal Bond Index	-0.85%	N/A	-5.14%	N/A	-2.22%	N/A	6.48
Taxable Municipal Bond: Agg Eligible	-2.72%	-0.16%	-6.89%	0.89%	-2.84%	4.00%	9.07
TIPS (Treasury Inflation Protected Securities)	-0.72%	0.00%	-3.43%	0.00%	-1.50%	0.00%	6.44

*Excess return represents the return of a spread sector versus a like-duration U.S. Treasury.

Disclosures

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.

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.

Indices are unmanaged, and are not available for direct investment. *Past performance is not a guarantee of future results.*

The Bloomberg U.S. Aggregate Bond Index is an index comprised of approximately 6000 publicly traded bonds including U.S. Government, mortgage-backed, corporate, and Yankee bonds with an average maturity of approximately 10 years.

The Bloomberg Government/Credit Index is a combination of the Government Index which measures government-bond general and Treasury funds, and the Credit Bond Index, which is a market value-weighted index which tracks the returns of all publicly issued, fixed-rate, nonconvertible, dollar-denominated, SEC registered, investment grade Corporate Debt.

The Bloomberg Intermediate U.S. Government/Credit Bond Index is a combination of the Government Index which measures government-bond general and Treasury funds, and the Credit Bond Index, which is a market value-weighted index which tracks the returns of all publicly issued, fixed-rate, nonconvertible, dollar-denominated, SEC registered, investment grade Corporate Debt with maturities between one and ten years.

The Bloomberg 1-3 Year U.S. Government/Credit Bond Index is a combination of the Government Index which measures government-bond general and Treasury funds, and the Credit Bond Index, which is a market value-weighted index which tracks the returns of all publicly issued, fixed-rate, nonconvertible, dollar-denominated, SEC registered, investment grade Corporate Debt with maturities between zero and three years.

The Bloomberg U.S. Treasury Index includes public obligations of the U.S. Treasury. Treasury bills are excluded by the maturity constraint of at least one year but are part of a separate Short Treasury Index. In addition, certain special issues, such as state and local government series bonds (SLGs), as well as U.S. Treasury TIPS, are excluded. STRIPS are excluded from the index because their inclusion would result in double-counting. Securities in the Index roll up to the U.S. Aggregate, U.S. Universal, and Global Aggregate Indices. The U.S. Treasury Index was launched on January 1, 1973.

U.S. Agency: This index is the U.S. Agency component of the U.S. Government/Credit index. Publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government (such as USAID securities). The largest issues are Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System (FHLB). The index includes both callable and non-callable agency securities.

U.S Corporate – Investment Grade: This index is the Corporate component of the U.S. Credit index. It includes publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

CMBS (Commercial Mortgage-Backed Securities): This index is the CMBS component of the U.S. Aggregate index. The Bloomberg CMBS ERISA-Eligible Index is the ERISA-eligible component of the Bloomberg CMBS Index. This index, which includes investment grade securities that are ERISA eligible under the underwriter's exemption, is the only CMBS sector that is included in the U.S. Aggregate Index.

MBS (Mortgage-Backed Securities): This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC). The MBS Index is formed by grouping the universe of over 600,000 individual fixed rate MBS pools into approximately 3,500 generic aggregates.

ABS (Asset-Backed Securities): This index is the ABS component of the U.S. Aggregate index. The ABS index has three subsectors: credit and charge cards, autos, and utility. The index includes pass-through, bullet, and controlled amortization structures. The ABS Index includes only the senior class of each ABS issue and the ERISA-eligible B and C tranche. The Manufactured Housing sector was removed as of January 1, 2008, and the Home Equity Loan sector was removed as of October 1, 2009.

Corporate High Yield: The Bloomberg U.S. High Yield Index covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included.

Emerging Market: Bloomberg uses a fixed list of countries defined as emerging markets countries for index inclusion purposes that is based on World Bank Income group definitions (Low/Middle), IMF country classifications (Non-Advanced Economies), and other advanced economies that may be less accessible or investable for global debt investors.

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 Bloomberg TIPS Index consists of Treasury Inflation Protected Securities (TIPS). TIPS are securities whose principal is tied to the Consumer Price Index. TIPS pay interest semi-annually, based on the fixed rate applied to the adjusted principal.

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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