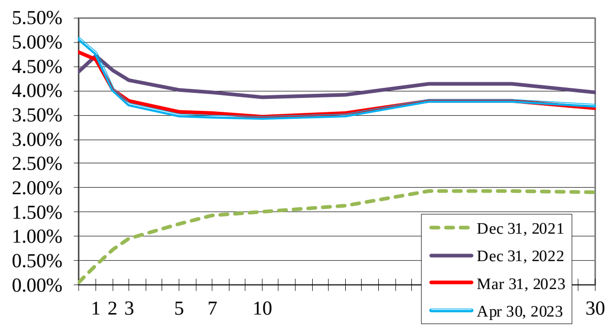
Baird Advisors
Fixed Income Market Commentary
April 2023

Treasury Yields Stabilize Despite Sticky Inflation Data and Looming Debt Ceiling Uncertainty

The Treasury yield curve was little changed in April with 2yr and 10yr yields lower by 2 bps and 4 bps, respectively, leaving the 2s-10s curve only slightly more inverted at – 58 bps. Despite relatively docile Treasury moves in April, the Fed continues to battle against a stubborn inflation opponent. Last month, the Fed's preferred inflation measure, Core PCE, fell just 0.1% to 4.6% YoY, unchanged since year end. Not surprisingly, the market now expects the Fed to raise the federal funds rate by 25 bps once again at the May FOMC meeting. Yet, fallout from the aggressive Fed tightening continues to emerge. First Republic Bank, plagued in recent months by unrealized losses on its balance sheet and the flight of deposits, was sold at month end to JP Morgan in an FDIC-administered deal. With assets of $233B (as of 3/31), First Republic is the largest bank failure since 2008 when JP Morgan acquired Washington Mutual. While the jobs market remains strong, Initial Jobless Claims have risen modestly, averaging 239k per week over the last two months, up from a 207k weekly average in the second half of 2022. Finally, the House passed a bill to raise the debt ceiling requiring significant spending cuts, placing the onus now on the Senate and Biden Administration to offer their plan before the Treasury runs out of funds necessary to enable normal governmental and financial market functions.

Treasury Yields



Maturity	12/31/21	12/31/22	3/31/23	4/30/23	1 Mo Chg	YTD Chg
3 Mo	0.06%	4.41%	4.80%	5.08%	0.28%	0.67%
1	0.39%	4.73%	4.65%	4.78%	0.13%	0.05%
2	0.74%	4.43%	4.03%	4.01%	-0.02%	-0.42%
3	0.96%	4.23%	3.79%	3.72%	-0.07%	-0.51%
5	1.27%	4.01%	3.58%	3.49%	-0.09%	-0.52%
7	1.44%	3.97%	3.54%	3.47%	-0.07%	-0.50%
10	1.51%	3.88%	3.47%	3.43%	-0.04%	-0.45%
20	1.94%	4.15%	3.80%	3.80%	0.00%	-0.35%
30	1.91%	3.97%	3.65%	3.68%	0.03%	-0.29%

Financials Subsector Tightens, Agency RMBS Widens

IG Corporate spreads ended April tighter (-2 bps) with the Financials subsector tightening most (-7 bps), reversing some of March's underperformance. Agency RMBS widened (+ 3 bps) on increased secondary supply as the FDIC began liquidating SVB/Signature balance sheet assets. Non-Agency CMBS tightened (-5 bps) in April, bifurcated by quality as AAA-rated tightened (-9 bps) amid wider BBB-rated (+35 bps) spreads. EM Debt was an outlier as spreads moved markedly wider for the month (+17 bps) and year (+61 bps).

Income (Carry) Helps Lift Returns in Sideways Month

The US Agg Index returned 0.61% in April, bringing YTD returns to 3.59%. Carry helped lift excess returns in many spread sectors during the month in the face of below-trend volatility in April. CMBS excess returns led IG sectors at +0.25% for the month but remain behind YTD (-0.48%). Agency RMBS was the only IG sector with negative excess returns in April (-0.10%). IG Corporate generated +0.18% of monthly excess return, additionally supported by light issuance.

Option-Adjusted Spreads (in bps)

	12/31/21	12/31/22	3/31/23	4/30/23	1Mo Chg	YTD Chg
U.S. Aggregate Index	36	51	57	57	0	6
U.S. Agency (non-mortgage)	8	26	28	28	0	2
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)	31	51	63	66	3	15
U.S. Agency CMBS	34	52	62	63	1	11
U.S. Non-Agency CMBS	95	179	215	210	-5	31
Asset-Backed Securities	38	76	85	83	-2	7
Corporate Sectors						
U.S. Investment Grade	92	130	138	136	-2	6
Industrial	95	125	124	124	0	-1
Utility	107	129	136	133	-3	4
Financial Institutions	83	140	164	157	-7	17
Non-Corporate Credit	55	66	68	64	-4	-2
U.S. High Yield Corporates	283	469	455	452	-3	-17
Emerging Market Debt	581	687	731	748	17	61

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total Return	MTD Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	0.61%	0.04%	3.59%	-0.05%	6.33
U.S. Gov't/Credit Index	0.63%	0.08%	3.82%	0.17%	6.55
U.S. Intermediate Gov't/Credit Index	0.61%	0.07%	2.96%	0.11%	3.85
U.S. 1-3 Yr. Gov't/Credit Index	0.34%	0.07%	1.86%	-0.01%	1.86
U.S. Treasury	0.54%	0.00%	3.56%	0.00%	6.28
U.S. Agency (Non-Mortgage)	0.41%	0.00%	2.51%	0.00%	3.18
U.S. Agency RMBS (Pass-Throughs)	0.52%	-0.10%	3.06%	-0.60%	5.93
CMBS (Commercial Mortgage Backed Securities)	0.86%	0.25%	2.69%	-0.48%	4.53
ABS (Asset-Backed Securities)	0.50%	0.16%	2.37%	0.11%	2.87
U.S. Corporate Investment Grade	0.77%	0.18%	4.29%	0.40%	7.23
U.S. High Yield Corporates	1.00%	0.48%	4.60%	1.73%	3.61
Emerging Market Debt	-0.93%	-1.54%	0.49%	-2.82%	4.97
Municipal Bond Index	-0.23%	N/A	2.54%	N/A	6.07
TIPS (Treasury Inflation Protected Securities)	0.11%	0.00%	3.45%	0.00%	6.89

*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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