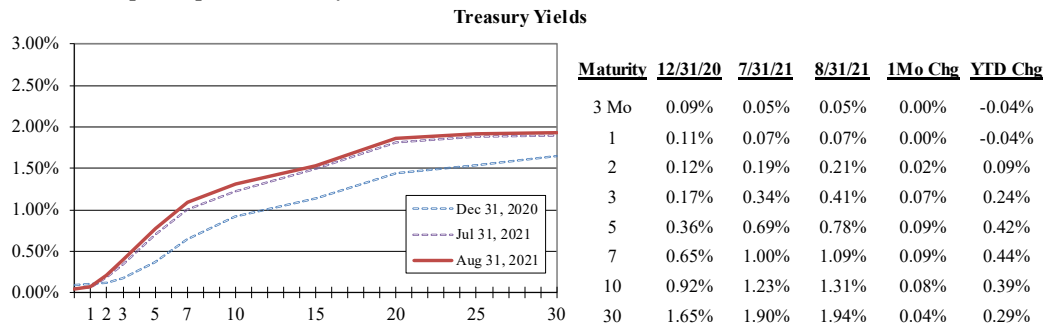


Baird Advisors
Fixed Income Market Commentary
August 2021

Yields Rise Modestly as Fed Confirms Tapering Likely to Begin in 2021; Delta Cases Rise

The benchmark 10yr Treasury yield rose 8 bps during the month to end August at 1.31%. Yields of intermediate maturities were modestly higher (3yr +7 bps, 5yr +9 bps), while increases in the short and long ends of the curve were more muted (1yr unchanged, 30yr +4 bps). At the annual Jackson Hole Symposium hosted by the Kansas City Fed, Chair Jerome Powell's keynote speech was positively received by the market that was expecting a cautious, dovish message. Powell said that though they have seen "clear progress" there is still "much ground to cover to reach maximum employment" implying they had not yet seen the "substantial progress" required to begin tapering bond purchases. He also essentially separated the more near-term decision to taper from the decision to eventually raise rates by stating that rate hikes require a "different and substantially more stringent test." He did share that he was one of the FOMC members at the July meeting who thought taper could start by year end if monthly job gains remained strong. The Fed is currently buying \$40B Agency MBS and \$80B Treasuries, for a total of \$120B added to the balance sheet every month. Delta variant cases continue to rise, placing strain on the medical system and leading many employers to postpone return-to-office plans, though lockdowns like 2020 are unlikely. Supply chain bottlenecks continue to act as a headwind to what is still a large rebound in economic growth (Q2 GDP +6.6% annualized QoQ) while placing upward pressure on inflation measures (CPI +5.4% YoY through July). The Biden administration completed the withdrawal from Afghanistan as all U.S. troops left the country by August 31st. The chaotic exit was criticized by both sides of the aisle on the Biden administration's handling of the withdrawal which could have an impact on midterm elections, potentially leading to a shift of power in Congress. As expected, the Senate gave overwhelming bipartisan approval to a \$1 trillion infrastructure bill (\$550B in new federal spending and \$450B renewing existing programs); the House hopes to pass the bill by October.



Spreads Relatively Unchanged in August; Still Tighter YTD

Spreads across investment grade sectors ended the month of August little changed from July, while spreads in below investment grade sectors such as Emerging Market Debt (23 bps tighter in August, 23 bps wider YTD) and High Yield Corporates (6 bps tighter in August, 72 bps tighter YTD) saw larger moves. Investment grade sectors appear to be taking a wait-and-see approach with regard to the impact on the economy from the surge in the Delta variant and whether the timing of taper will be affected.

Option-Adjusted Spreads (in bps)

	12/31/20	7/31/21	8/31/21	1Mo Chg	YTD Chg
U.S. Aggregate Index	42	35	35	0	-7
U.S. Agency (non-mortgage)	10	3	2	-1	-8
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	39	31	33	2	-6
U.S. Agency CMBS	44	31	30	-1	-14
U.S. Non-Agency CMBS	109	86	85	-1	-24
Asset-Backed Securities	33	26	27	1	-6
Corporate Sectors					
U.S. Investment Grade	96	86	87	1	-9
Industrial	101	89	90	1	-11
Utility	106	97	100	3	-6
Financial Institutions	83	76	76	0	-7
Non-Corporate Credit	66	53	50	-3	-16
U.S. High Yield Corporates	360	294	288	-6	-72
Emerging Market Debt	503	549	526	-23	23

Source: Bloomberg Indices

Market Returns Generally Negative in August; Mixed YTD

Returns were generally negative in August, with below investment grade sectors (HY Corporates +0.51%; EM +1.33%) outperforming IG as rates rose. ABS was the best-performing investment grade sector for the month (-0.01%). Bond markets typically experience a seasonal summer lull in trading volumes and issuance.

Total Returns of Selected Bloomberg Indices and Subsectors

	August	YTD	Effective Duration (years)
U.S. Aggregate Index	-0.19%	-0.69%	6.65
U.S. Gov't/Credit Index	-0.20%	-0.87%	7.68
U.S. Intermediate Gov't/Credit Index	-0.16%	-0.30%	4.18
U.S. 1-3 Yr. Gov't/Credit Index	0.00%	0.17%	1.93
U.S. Treasury	-0.17%	-1.43%	7.16
U.S. Agency (Non-Mortgage)	-0.09%	-0.20%	3.73
U.S. Agency Pass-Throughs	-0.16%	-0.31%	4.16
CMBS (Commercial Mortgage Backed Securities)	-0.18%	0.24%	5.16
ABS (Asset-Backed Securities)	-0.01%	0.38%	2.21
U.S. Corporate Investment Grade	-0.30%	-0.22%	8.78
U.S. High Yield Corporates	0.51%	4.55%	3.87
Emerging Market Debt	1.33%	1.46%	5.50
Municipal Bond Index	-0.37%	1.53%	5.12
TIPS (Treasury Inflation Protected Securities)	-0.18%	4.26%	8.03

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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