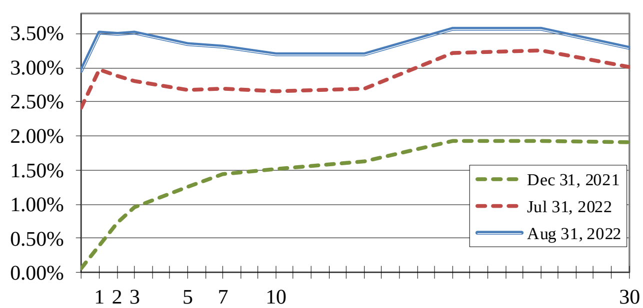
Baird Advisors
Fixed Income Market Commentary
August 2022

Bond Yields Rise on Strong Data and Hawkish Fed Messaging

Investors focused on resilient U.S. economic data and the Fed's inflation fighting resolve, lifting Treasury yields across all maturities. The 10yr Treasury yield rose 55 bps to 3.20%, just 27 bps below its YTD peak in mid-June. August began with a strong jobs report (+528k) which also featured upward revisions to prior months (+28k), a cycle-low unemployment rate (3.5%) and robust wage gains (average hourly earnings rose 5.2% YoY). U.S. headline CPI fell from its recent 9.1% peak but remained elevated at 8.5%. Congress passed the Inflation Reduction Act along party lines and the bill was signed into law by President Biden. The $485B legislation promotes clean energy investments while also extending Affordable Care Act subsidies. The plan's cost is offset by various sources, including a 15% corporate minimum tax, prescription drug pricing reforms and IRS tax enforcement. Fed Chair Powell reinforced his commitment to fighting inflation in an eight minute speech at the Jackson Hole WY Summit, noting that economic "pain" may result from tighter monetary policy but sought to avoid Fed mistakes of the 1970s when policy tightening was curbed prematurely only to allow inflation to reaccelerate. Despite the noted job strength above, signs of slowing are emerging, most notably in the housing sector where higher mortgage rates are impacting sales. July's new single-family home sales fell 12.6% from the prior month while existing home sales fell 5.9%. Softening commodity prices are becoming more evident as well, signaling slowing in the global economy.

Treasury Yields



Maturity	12/31/21	7/31/22	8/31/22	1Mo Chg	YTD Chg
3 Mo	0.06%	2.41%	2.95%	0.54%	2.89%
1	0.39%	2.98%	3.53%	0.55%	3.14%
2	0.74%	2.89%	3.50%	0.61%	2.76%
3	0.96%	2.81%	3.52%	0.71%	2.56%
5	1.27%	2.68%	3.35%	0.67%	2.08%
7	1.44%	2.69%	3.31%	0.62%	1.87%
10	1.51%	2.65%	3.20%	0.55%	1.69%
20	1.94%	3.22%	3.57%	0.35%	1.63%
30	1.91%	3.01%	3.30%	0.29%	1.39%

U.S. Agency RMBS Widens in August, a Reversal from July

Following record returns vs Treasuries in July on hopes of reduced Fed tightening including outright sales of mortgages, Agency RMBS experienced outsized widening relative to other sectors in August as demand waned on tighter valuations. Continuing the tightening trend from early July, IG Corporate spreads reached 131 bps before widening in late August to close at 140 bps, still 4 tighter on the month. Financials tightened most in August (-6 bps). ABS spreads tightened (-20 bps) as did non-Agency CMBS (-7 bps) for the month. U.S. High Yield spreads widened (+15) in sympathy with declines in U.S. equities. Emerging Market spreads tightened (-69 bps) but remain notably wider YTD (+176 bps).

Agg Index Monthly Returns Negative for 6th Time in 2022

The Agg Index followed its best YTD monthly return in July by declining in August (-2.83%). Returns were negative for all major bond sectors for the month aside from Emerging Markets (+0.82%), which remains firmly negative YTD (-15.52%). U.S. Agency RMBS had the lowest monthly excess return (-1.00%) while most sectors produced positive excess returns in August.

Option-Adjusted Spreads (in bps)

	12/31/21	7/31/22	8/31/22	1Mo Chg	YTD Chg
U.S. Aggregate Index	36	49	50	1	14
U.S. Agency (non-mortgage)	8	21	19	-2	11
Mortgage and ABS Sectors					
U.S. Agency RMBS (Pass-throughs)	31	27	40	13	9
U.S. Agency CMBS	34	49	50	1	16
U.S. Non-Agency CMBS	95	154	147	-7	52
Asset-Backed Securities	38	82	62	-20	24
Corporate Sectors					
U.S. Investment Grade	92	144	140	-4	48
Industrial	95	140	138	-2	43
Utility	107	146	141	-5	34
Financial Institutions	83	150	144	-6	61
Non-Corporate Credit	55	77	69	-8	14
U.S. High Yield Corporates	283	469	484	15	201
Emerging Market Debt	581	826	757	-69	176

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	-2.83%	-0.25%	-10.75%	-1.08%	6.36
U.S. Gov't/Credit Index	-2.61%	0.05%	-11.49%	-0.96%	6.67
U.S. Intermediate Gov't/Credit Index	-2.00%	0.05%	-7.14%	-0.50%	3.93
U.S. 1-3 Yr. Gov't/Credit Index	-0.78%	0.00%	-3.36%	-0.10%	1.90
U.S. Treasury	-2.48%	0.00%	-9.98%	0.00%	6.36
U.S. Agency (Non-Mortgage)	-1.67%	-0.07%	-6.55%	-0.62%	3.50
U.S. Agency RMBS (Pass-Throughs)	-3.42%	-1.00%	-9.07%	-1.42%	5.76
CMBS (Commercial Mortgage-Backed Sec.)	-2.55%	0.00%	-8.98%	-0.90%	4.79
ABS (Asset-Backed Securities)	-0.66%	0.27%	-3.94%	-0.24%	2.22
U.S. Corporate Investment Grade	-2.93%	0.08%	-14.21%	-2.44%	7.47
U.S. High Yield Corporates	-2.30%	-0.28%	-11.22%	-5.00%	4.11
Emerging Market Debt	0.82%	3.37%	-15.52%	-7.25%	5.04
Municipal Bond Index	-2.19%	N/A	-8.62%	N/A	6.83
TIPS (Treasury Inflation Protected Sec.)	-2.66%	0.00%	-7.49%	0.00%	7.34

*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.

RB2021-0805

Robert W. Baird & Co. Incorporated