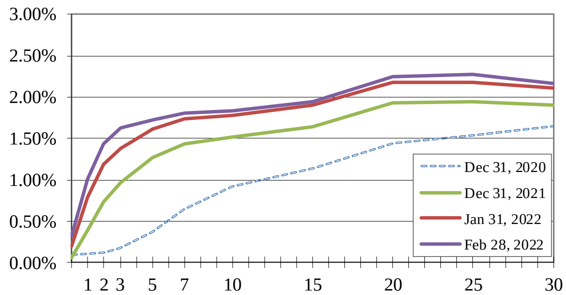
Baird Advisors
Fixed Income Market Commentary
February 2022

Russian Invasion of Ukraine Moves Markets

February began with strong U.S. economic data. January nonfarm payrolls of 467k new jobs was well above the 125k survey estimate and prior monthly data was also revised upward. Inflation continued to surprise to the upside as prices rose MoM by 0.6%, resulting in a CPI increase of 7.5% YoY, the highest in 40 years. Treasury yields climbed sharply on the data with the 10yr yield increasing from 1.78% to 2.04% by mid month on expectations that the Fed would hike rates at a faster pace than previously expected. Two-year yields rose 26 bps to 1.44% while 10yr and 30yr yields only rose 5 and 6 bps, respectively, flattening the curve. Meanwhile, tensions continued to rise in Europe as Russia amassed 150,000 troops at the Ukrainian border. Russia mobilized into the separatist-held Donbas region of Eastern Ukraine on February 21st as “peacekeepers,” with U.S. markets closed for Presidents’ Day, and quickly followed with a broader invasion of Ukraine on Thursday, February 24th. As investors began to rethink both the impact for global growth (slower) and monetary policy (fewer rate hikes), Treasury yields fell sharply in the final trading days of the month. The 10yr Treasury yield fell to 1.83%, up just 5 bps for the month. Oil prices, along with other commodities, continued their upward trend, adding to the already concerning inflation picture. WTI crude ended the month at $95.72/bbl, up 9% for the month and 27% since year end.

Treasury Yields



Maturity	12/31/20	12/31/21	1/31/22	2/28/22	1Mo Chg	YTD Chg
3 Mo	0.09%	0.06%	0.19%	0.32%	0.13%	0.26%
1	0.11%	0.39%	0.79%	1.01%	0.22%	0.62%
2	0.12%	0.74%	1.18%	1.44%	0.26%	0.70%
3	0.17%	0.96%	1.38%	1.63%	0.25%	0.67%
5	0.36%	1.27%	1.61%	1.72%	0.11%	0.45%
7	0.65%	1.44%	1.74%	1.81%	0.07%	0.37%
10	0.92%	1.51%	1.78%	1.83%	0.05%	0.32%
30	1.65%	1.91%	2.11%	2.17%	0.06%	0.26%

Credit Spreads Wider in February, Continuing YTD Trend

Investment Grade Corporate spreads widened 16 bps in February, bringing the YTD widening to 30 bps. Fed tightening expectations, global uncertainty and mutual fund outflows weighed on the credit markets. RMBS, CMBS and ABS sectors also widened in February with the largest increase in Non-Agency CMBS (24 bps). High Yield spreads increased 17 bps for the month and are 76 bps wider YTD. Emerging Markets experienced the largest move as spreads increased 79 bps for the month and 94 bps YTD.

Returns Negative, Agg Index Yield Climbs

Monthly index returns were negative for all sectors aside from TIPS (0.85%) with the Aggregate Index returning -1.12%. The yield on the Aggregate Index, which stood at 2.33% month-end, has risen 131 bps from the August 2021 low. The sharpest subsector declines in February occurred in Emerging Market Debt (-4.27%). IG Corporate declines (-2.00%) are a function of their tendency to reprice quickly in a spread widening environment but also due to the sector’s higher average duration. Some sectors have experienced less repricing due to thinner trading. Municipals followed notable underperformance to the Aggregate in January with a smaller decline in February (-0.36%).

Option-Adjusted Spreads (in bps)

	12/31/20	12/31/21	1/31/22	2/28/22	1Mo Chg	YTD Chg
U.S. Aggregate Index	42	36	36	43	7	7
U.S. Agency (non-mortgage)	10	8	9	13	4	5
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)	39	31	18	28	10	-3
U.S. Agency CMBS	44	34	34	39	5	5
U.S. Non-Agency CMBS	109	95	96	120	24	25
Asset-Backed Securities	33	38	30	44	14	6
Corporate Sectors						
U.S. Investment Grade	96	92	106	122	16	30
Industrial	101	95	109	124	15	29
Utility	106	107	117	136	19	29
Financial Institutions	83	83	97	115	18	32
Non-Corporate Credit	66	55	59	66	7	11
U.S. High Yield Corporates	360	283	342	359	17	76
Emerging Market Debt	503	581	596	675	79	94

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	February	YTD	Effective Duration (years)
U.S. Aggregate Index	-1.12%	-3.25%	6.59
U.S. Gov’t/Credit Index	-1.17%	-3.58%	7.35
U.S. Intermediate Gov’t/Credit Index	-0.66%	-2.11%	4.09
U.S. 1-3 Yr. Gov’t/Credit Index	-0.44%	-1.15%	1.92
U.S. Treasury	-0.66%	-2.54%	6.98
U.S. Agency (Non-Mortgage)	-0.67%	-1.90%	3.81
U.S. Agency RMBS (Pass-Throughs)	-0.97%	-2.44%	4.84
CMBS (Commercial Mortgage-Backed Securities)	-1.20%	-2.77%	5.00
ABS (Asset-Backed Securities)	-0.63%	-1.19%	2.28
U.S. Corporate Investment Grade	-2.00%	-5.30%	8.25
U.S. High Yield Corporates	-1.03%	-3.73%	4.03
Emerging Market Debt	-4.27%	-6.14%	5.41
Municipal Bond Index	-0.36%	-3.09%	5.14
TIPS (Treasury Inflation Protected Securities)	0.85%	-1.19%	7.76

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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