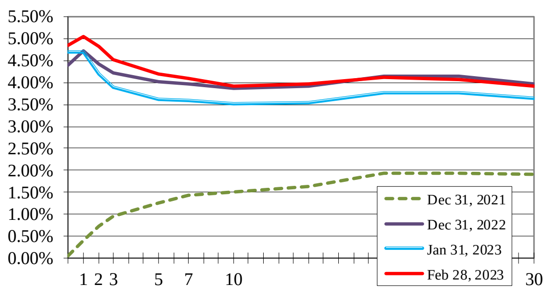
Baird Advisors
Fixed Income Market Commentary
February 2023

Treasury Yields Rose in February on Stronger than Expected Growth and Inflation Data

The 10yr Treasury yield rose 42bps in February, reversing all the January decline and finished the month at 3.93%, 5 bps above where it began the year. Short-term Treasury yields rose the most in a bear flattening trend, deepening the curve inversion between 2's-10's to a 40-year low of -89 bps. Market views on the likely path for the federal funds rate shifted meaningfully higher, from below the Fed's December projections to now above. The anticipated peak rate rose to 5.4% during February from 4.9% last month with expectations of a Fed "pivot" (ease) before year end almost gone. In the minutes from the recent FOMC meeting (1/30 & 2/1) the participants agreed that "inflation was unacceptably high" and "it was likely to take some time" before they were confident of achieving their 2% inflation target. Supporting this higher for longer view was robust economic data in January, including nonfarm payrolls (+517k vs +189k est.), personal spending (+1.8% vs 1.4% est.) and CPI (+6.4% YoY vs +6.2% est.). Geopolitical tensions rose during the month as a Chinese spy balloon crossed the continental U.S. before being shot down off the South Carolina coast and the Russia-Ukraine War marked a one-year anniversary. Despite YTD market volatility, IG fixed income fund flows have been positive, with eight straight weeks of inflows through month end, the longest stretch since October 2021.

Treasury Yields



Maturity	12/31/21	12/31/22	1/31/23	2/28/23	1 Mo Chg	YTD Chg
3 Mo	0.06%	4.41%	4.69%	4.85%	0.16%	0.44%
1	0.39%	4.73%	4.69%	5.04%	0.35%	0.31%
2	0.74%	4.43%	4.21%	4.82%	0.61%	0.39%
3	0.96%	4.23%	3.90%	4.53%	0.63%	0.30%
5	1.27%	4.01%	3.62%	4.19%	0.57%	0.18%
7	1.44%	3.97%	3.58%	4.09%	0.51%	0.12%
10	1.51%	3.88%	3.51%	3.93%	0.42%	0.05%
20	1.94%	4.15%	3.77%	4.11%	0.34%	-0.04%
30	1.91%	3.97%	3.64%	3.92%	0.28%	-0.05%

Spreads Mixed in February, Tighter YTD

IG Corporate spreads moved wider in February by 7 bps on outsized issuance, ending the 4-month tightening streak, but remain tighter YTD (-6 bps). Financials have tightened most among IG Corporate sectors YTD (-14 bps). Agency RMBS moved similarly; +5 bps wider for the month but -5 bps tighter YTD. Non-Agency CMBS and ABS were both tighter for the month and the year. The tightening trend remained intact for HY Corporates in February (-8 bps) and YTD (-57 bps). EM debt widened notably for the month (+23 bps) but remains tighter YTD (-17 bps).

February Declines Reverse January Strength

US Aggregate index return of -2.59% offset much of January's rally leaving the index up +0.41% YTD. CMBS (+0.24%) and ABS (+0.26%) produced positive excess returns in February. Agency RMBS (-0.29%) and US Corporate (-0.54%) monthly excess returns were negative. YTD excess returns remained positive across major US bond sectors, particularly CMBS (+0.95%) and US Corporate (+0.61%). HY Corporate produced the highest excess monthly (+0.39%) and YTD (2.55%) returns.

Option-Adjusted Spreads (in bps)

	12/31/21	12/31/22	1/31/23	2/28/23	1Mo Chg	YTD Chg
U.S. Aggregate Index	36	51	45	48	3	-3
U.S. Agency (non-mortgage)	8	26	25	24	-1	-2
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)	31	51	41	46	5	-5
U.S. Agency CMBS	34	52	45	43	-2	-9
U.S. Non-Agency CMBS	95	179	161	155	-6	-24
Asset-Backed Securities	38	76	65	57	-8	-19
Corporate Sectors						
U.S. Investment Grade	92	130	117	124	7	-6
Industrial	95	125	114	122	8	-3
Utility	107	129	120	130	10	1
Financial Institutions	83	140	122	126	4	-14
Non-Corporate Credit	55	66	65	61	-4	-5
U.S. High Yield Corporates	283	469	420	412	-8	-57
Emerging Market Debt	581	687	647	670	23	-17

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	-2.59%	-0.19%	0.41%	0.36%	6.26
U.S. Gov't/Credit Index	-2.59%	-0.17%	0.34%	0.25%	6.40
U.S. Intermediate Gov't/Credit Index	-1.80%	-0.03%	0.04%	0.21%	3.82
U.S. 1-3 Yr. Gov't/Credit Index	-0.74%	0.00%	0.05%	0.07%	1.87
U.S. Treasury	-2.34%	0.00%	0.11%	0.00%	6.14
U.S. Agency (Non-Mortgage)	-1.32%	0.02%	0.16%	0.16%	3.25
U.S. Agency RMBS (Pass-Throughs)	-2.64%	-0.29%	0.57%	0.60%	6.08
CMBS (Commercial Mortgage-Backed Sec.)	-1.87%	0.24%	0.72%	0.95%	4.54
ABS (Asset-Backed Securities)	-0.85%	0.26%	0.55%	0.54%	2.84
U.S. Corporate Investment Grade	-3.18%	-0.54%	0.70%	0.61%	7.06
U.S. High Yield Corporates	-1.29%	0.39%	2.47%	2.55%	3.78
Emerging Market Debt	-2.58%	-0.36%	1.54%	1.69%	4.97
Municipal Bond Index	-2.26%	N/A	0.55%	N/A	6.15
TIPS (Treasury Inflation Protected Sec.)	-1.37%	0.00%	0.44%	0.00%	6.83

*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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