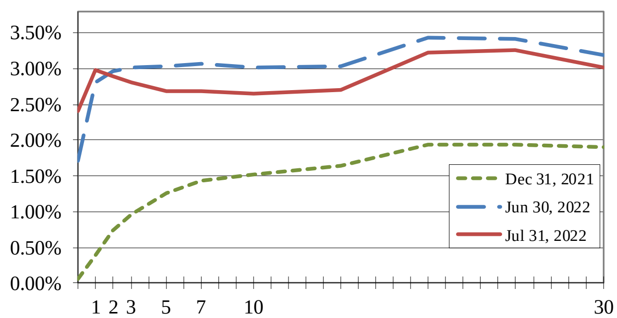
Baird Advisors
Fixed Income Market Commentary
July 2022

Real GDP Declines in Back-to-Back Quarters, Fixed Income Rallies Sharply

Treasury rates fell sharply in July as investor attention shifted from inflation to slowing growth. The 10yr Treasury yield fell 37 bps to 2.65%, 83 bps below its 2022 peak. The decline in rates occurred despite the highest US CPI print (9.1% YoY) and the largest two-month increase in the federal funds rate (150 bps) since the early-1980s; the Fed raised the policy rate by 75 bps in both June and July. Importantly, Fed Chair Powell pivoted away from forward guidance, allowing the FOMC more flexibility from meeting to meeting based on evolving economic data. The Treasury rally accelerated while a recession debate ensued. Q2 real GDP declined at a -0.9% annualized rate following a revised -1.6% contraction in Q1. While the back-to-back quarterly decline in GDP meets a common perception of a recession, any official declaration must come from the National Bureau of Economic Research (NBER) and is typically announced well after it has begun. Signs of slower growth are becoming more evident with rising initial jobless claims and weaker housing-related activity. Global growth is also slowing as other central banks simultaneously fight inflation. Fortunately for the Fed, longer-term inflation expectations came down in July, a supportive sign for the Fed's inflation fighting credibility. Another sign of the Fed's resolve, and the market's concern, is the re-inversion of the Treasury curve. The 2yr – 10yr segment briefly inverted in April but moved deeper into negative territory recently, ending July at a spread of -24 bps.

Treasury Yields



Maturity	12/31/21	3/31/22	6/30/22	7/31/22	1Mo Chg	YTD Chg
3 Mo	0.06%	0.51%	1.71%	2.41%	0.70%	2.35%
1	0.39%	1.62%	2.81%	2.98%	0.17%	2.59%
2	0.74%	2.34%	2.96%	2.89%	-0.07%	2.15%
3	0.96%	2.52%	3.01%	2.81%	-0.20%	1.85%
5	1.27%	2.46%	3.04%	2.68%	-0.36%	1.41%
7	1.44%	2.44%	3.08%	2.69%	-0.39%	1.25%
10	1.51%	2.34%	3.02%	2.65%	-0.37%	1.14%
30	1.91%	2.45%	3.19%	3.01%	-0.18%	1.10%

Corporate Spreads Tighten from Early July Peak

IG Corporate spreads reached 160 bps on July 5 before declining 16 bps to end the month at 144 bps. Cheaper valuations, expectations for inflation containment, and a potentially less-hawkish Fed than expected sparked a rally in spreads. Agency RMBS tightened considerably in July (-19). CMBS and ABS both saw spreads move wider. US High Yield tightened dramatically (-100 bps). Emerging Market debt, still challenged by a strong dollar, only tightened 9 bps and spreads remain elevated at 826 bps.

Agg Index Monthly Return Highest of 2022

The Aggregate Index delivered its highest monthly return (+2.44%) and only its second positive monthly result this year. All major US fixed income sectors posted positive monthly returns. Tighter spreads also led to positive MTD excess returns for Agency RMBS and IG Corporate. Agency, CMBS, ABS and Emerging Markets each produced negative excess returns for the month. US High Yield had the highest total return (+5.90%) and excess return (+4.34%) in July. Returns for all sectors remain negative YTD.

Option-Adjusted Spreads (in bps)

	12/31/21	3/31/22	6/30/22	7/31/22	1Mo Chg	YTD Chg
U.S. Aggregate Index	36	41	55	49	-6	13
U.S. Agency (non-mortgage)	8	13	17	21	4	13
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)	31	24	46	27	-19	-4
U.S. Agency CMBS	34	44	41	49	8	15
U.S. Non-Agency CMBS	95	119	152	154	2	59
Asset-Backed Securities	38	57	75	82	7	44
Corporate Sectors						
U.S. Investment Grade	92	116	155	144	-11	52
Industrial	95	116	153	140	-13	45
Utility	107	127	156	146	-10	39
Financial Institutions	83	112	159	150	-9	67
Non-Corporate Credit	55	62	72	77	5	22
U.S. High Yield Corporates	283	325	569	469	-100	186
Emerging Market Debt	581	618	835	826	-9	245

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	2.44%	0.62%	-8.16%	-0.88%	6.40
U.S. Gov't/Credit Index	2.16%	0.38%	-9.12%	-1.03%	6.84
U.S. Intermediate Gov't/Credit Index	1.63%	0.23%	-5.25%	-0.56%	3.97
U.S. 1-3 Yr. Gov't/Credit Index	0.53%	0.10%	-2.60%	-0.10%	1.90
U.S. Treasury	1.59%	0.00%	-7.69%	0.00%	6.49
U.S. Agency (Non-Mortgage)	1.08%	-0.02%	-4.96%	-0.56%	3.57
U.S. Agency RMBS (Pass-Throughs)	3.21%	1.29%	-5.85%	-0.48%	5.48
CMBS (Commercial Mortgage-Backed Sec.)	1.83%	-0.01%	-6.60%	-0.93%	4.88
ABS (Asset-Backed Securities)	0.49%	-0.10%	-3.30%	-0.51%	2.21
U.S. Corporate Investment Grade	3.24%	1.09%	-11.61%	-2.59%	7.70
U.S. High Yield Corporates	5.90%	4.34%	-9.12%	-4.84%	4.02
Emerging Market Debt	1.73%	-0.02%	-16.21%	-10.33%	5.15
Municipal Bond Index	2.64%	N/A	-6.58%	N/A	6.58
TIPS (Treasury Inflation Protected Sec.)	4.35%	0.00%	-4.96%	0.00%	7.36

*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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