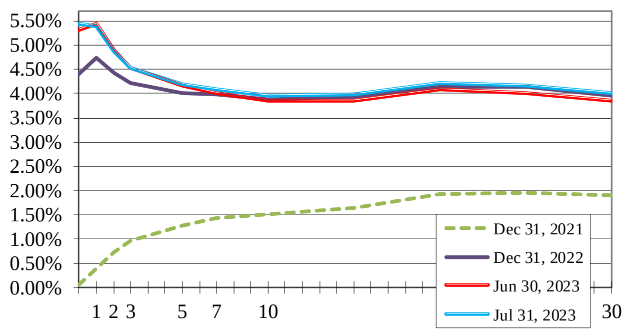
Baird Advisors
Fixed Income Market Commentary
July 2023

Fed Hikes in July, US GDP Strength Lifts Long Treasury Yields

Following the pause in June, the Fed voted to raise the federal funds rate by 25 bps at the July FOMC meeting, pushing the top end of the target range to 5.50%. 10yr Treasury yields rose 13 bps to 3.97% in July and 2yr yields fell 2 bps, steepening the curve. Still, the 2s10s yield slope remained deeply inverted at -91 bps. While the 2yr Treasury yield declined to 4.88%, it remains just 19 bps shy of its cycle high. Fed Chair Powell reiterated at the post-meeting press conference that the Fed is data dependent for future rate moves and will take a "meeting by meeting approach." He underscored the ongoing commitment to its 2% inflation goal, citing two additional employment and inflation reports before its September meeting where another 25-bp rate hike remains "on the table." Economic data remained relatively strong, including still robust payroll growth of 209k from June (although slightly below the +230k estimate) and low initial unemployment claims. Growth in 2Q, reported at an annual pace of 2.4%, exceeded the 1.8% consensus estimate, thanks, in part, to better-than-expected consumer spending. Despite resilient labor and growth trends, headline inflation has continued a downward path, recording a 3.0% YoY rate in July from 4.0% the prior month, due primarily to lower energy prices. Recent data has fostered investors' hopes for an economic "soft landing" rather than prior expectations of recession arriving later this year. Risk assets performed well on increased expectations for a soft landing. The S&P 500 rose over 3% in July and credit spreads tightened. IG Corporate Bond Index OAS of 112 is at its tightest level since April 2022.

Treasury Yields



Maturity	12/31/21	12/31/22	3/31/23	6/30/23	7/31/23	1 Mo Chg	YTD Chg
3 Mo	0.06%	4.41%	4.80%	5.31%	5.43%	0.12%	1.02%
1	0.39%	4.73%	4.65%	5.44%	5.40%	-0.04%	0.67%
2	0.74%	4.43%	4.03%	4.90%	4.88%	-0.02%	0.45%
3	0.96%	4.23%	3.79%	4.53%	4.53%	0.00%	0.30%
5	1.27%	4.01%	3.58%	4.16%	4.18%	0.02%	0.17%
7	1.44%	3.97%	3.54%	4.01%	4.09%	0.08%	0.12%
10	1.51%	3.88%	3.47%	3.84%	3.97%	0.13%	0.09%
20	1.94%	4.15%	3.80%	4.08%	4.21%	0.13%	0.06%
30	1.91%	3.97%	3.65%	3.86%	4.01%	0.15%	0.04%

Corporate and Non-Agy CMBS lead IG Spreads Tighter

IG Corporate spreads tightened -11 bps in July leaving the sector -18 bps tighter YTD. The Financials subsector tightened -14 bps despite being an outsized 64% of total monthly corporate issuance. Spreads also moved tighter in Non-Agy CMBS (-9 bps) but the sector remains wider YTD (+23 bps). Agency RMBS also tightened in July -4 bps resulting in the sector being tighter YTD (-3 bps). Spread tightening was outsized in US High Yield (-23 bps) and EM Debt (-49 bps).

Agg Index Modestly Negative in July

The US Agg Index declined -0.07% in July. Positive excess returns were prevalent across major spread sectors. IG Corporate debt rose 0.34% in July but delivered a robust 0.90% of excess returns, leading IG sectors. Agency RMBS excess returns were +0.28%. ABS nominal and excess returns were both positive in July (+0.42% and 0.23%, respectively). Excess returns, driven by outsized spread compression, were greatest in HY Corporate (+1.24%) and EM Debt (+2.73%).

Option-Adjusted Spreads (in bps)

	12/31/21	12/31/22	3/31/23	6/30/23	7/31/23	1Mo Chg	YTD Chg
U.S. Aggregate Index	36	51	57	49	46	-3	-5
U.S. Agency (non-mortgage)	8	26	28	19	20	1	-6
Mortgage and ABS Sectors							
U.S. Agency RMBS (Pass-throughs)	31	51	63	52	48	-4	-3
U.S. Agency CMBS	34	52	62	51	56	5	4
U.S. Non-Agency CMBS	95	179	215	211	202	-9	23
Asset-Backed Securities	38	76	85	68	63	-5	-13
Corporate Sectors							
U.S. Investment Grade	92	130	138	123	112	-11	-18
Industrial	95	125	124	113	104	-9	-21
Utility	107	129	136	132	120	-12	-9
Financial Institutions	83	140	164	139	125	-14	-15
Non-Corporate Credit	55	66	68	58	55	-3	-11
U.S. High Yield Corporates	283	469	455	390	367	-23	-102
Emerging Market Debt	581	687	731	681	632	-49	-55

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total Return	MTD Excess Return	3 Mo Total Return	3 Mo Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	-0.07%	0.32%	-1.51%	0.86%	2.02%	0.84%	6.27
U.S. Gov't/Credit Index	-0.08%	0.34%	-1.63%	0.76%	2.13%	0.95%	6.39
U.S. Intermediate Gov't/Credit Index	0.26%	0.17%	-1.16%	0.46%	1.77%	0.58%	3.79
U.S. 1-3 Yr. Gov't/Credit Index	0.42%	0.07%	-0.29%	0.18%	1.56%	0.18%	1.84
U.S. Treasury	-0.35%	0.00%	-2.25%	0.00%	1.23%	0.00%	6.12
U.S. Agency (Non-Mortgage)	0.17%	0.03%	-0.68%	0.34%	1.82%	0.35%	3.16
U.S. Agency RMBS (Pass-Throughs)	-0.07%	0.28%	-1.23%	1.13%	1.79%	0.58%	6.12
CMBS (Commercial Mortgage Backed Securities)	0.22%	0.21%	-1.24%	0.77%	1.42%	0.31%	4.43
ABS (Asset-Backed Securities)	0.42%	0.23%	-0.19%	0.66%	2.17%	0.78%	2.73
U.S. Corporate Investment Grade	0.34%	0.90%	-0.70%	2.00%	3.56%	2.47%	7.08
U.S. High Yield Corporates	1.38%	1.24%	2.13%	3.55%	6.83%	5.42%	3.45
Emerging Market Debt	2.60%	2.73%	5.90%	7.94%	6.41%	5.22%	5.09
Municipal Bond Index (Exempt)	0.40%	N/A	0.52%	N/A	3.08%	N/A	6.05
Taxable Municipal Bond: Agg Eligible	-0.65%	0.40%	-2.49%	1.20%	4.35%	3.33%	9.60
TIPS (Treasury Inflation Protected Securities)	0.13%	0.00%	-1.41%	0.00%	2.00%	0.00%	6.75

*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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