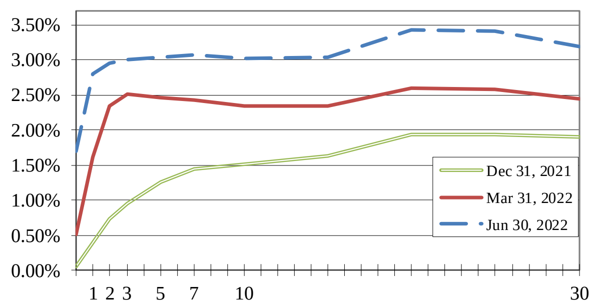
Baird Advisors
Fixed Income Market Commentary
June 2022

Upside Inflation Surprise Emboldens Hawkish Fed, Odds of Recession Rise

Volatility remained on center stage for the month and quarter. Headline CPI hit a new high of 8.6% in June, inching ahead of April's 8.5% level. The Fed, determined to catch-up with market expectations, boosted the Fed Funds rate by 75 bps in June, its largest move since 1994, and signaled a willingness to stay the course until inflation slows, even at the expense of economic growth. The curve flattened as short Treasury yields rose faster than longer yields for the month and quarter. The 10Y Treasury yield peaked at 3.47% on June 14, its highest reading since 2011, before falling to 3.02% at quarter end; up 17 bps for the month and 68 bps in Q2. Early signs of slowing were evident as recession odds rose. Initial weekly jobless claims are off their recent lows, even as the job market remains tight. Housing starts and building permits both slowed as mortgage rates have risen sharply, and retail sales are slowing due to inflationary pressure on prices. Most notable was the record low print of University of Michigan Survey of Consumer Sentiment in June (50.0), as respondents were pessimistic about future business conditions. Although near-term inflation pressures remain the primary concern, the Fed could be comforted by a sharp decline in market-based inflation expectations. For example, 10Y breakeven inflation rates fell 30 bps in June, from 2.65% to 2.35%.

Treasury Yields



Maturity	12/31/21	3/31/22	5/31/22	6/30/22	1Mo Chg	Q2 Chg	YTD Chg
3 Mo	0.06%	0.51%	1.08%	1.71%	0.63%	1.20%	1.65%
1	0.39%	1.62%	2.08%	2.81%	0.73%	1.19%	2.42%
2	0.74%	2.34%	2.56%	2.96%	0.40%	0.62%	2.22%
3	0.96%	2.52%	2.73%	3.01%	0.28%	0.49%	2.05%
5	1.27%	2.46%	2.82%	3.04%	0.22%	0.58%	1.77%
7	1.44%	2.44%	2.88%	3.08%	0.20%	0.64%	1.64%
10	1.51%	2.34%	2.85%	3.02%	0.17%	0.68%	1.51%
30	1.91%	2.45%	3.05%	3.19%	0.14%	0.74%	1.28%

Corporate Spreads Widen on Slowdown Concerns

IG Corporate spreads widened 25 bps in June and 39 bps for Q2 on greater risk aversion and diminishing market liquidity. Agency RMBS widened for June (+12) and Q2 (+22) as the Fed began allowing maturities of its RMBS holdings. Non-Agency CMBS and ABS both widened for the quarter with the best liquidity and performance found among more highly rated segments. High Yield and Emerging Market spreads widened materially in June as prices fell in sympathy with equities.

Sharply Negative Returns Cap Difficult 1H 2022

The Aggregate Index declined -1.57% in June and -4.69% for the quarter, bringing YTD returns to -10.35%, the weakest 6-month start to a year since index inception. IG Corporate, US High Yield and Emerging Market excess returns were lowest for the quarter, reflecting a slowing economy and fund outflows. IG outflows have persisted for 18 straight weeks, the longest cycle since 2004. ABS and CMBS had the highest monthly excess returns. TIPS declined -3.16% in June and -6.08% in Q2 as demand for future inflation protection fell.

Option-Adjusted Spreads (in bps)

	12/31/21	3/31/22	5/31/22	6/30/22	1Mo Chg	Q2 Chg	YTD Chg
U.S. Aggregate Index	36	41	46	55	9	14	19
U.S. Agency (non-mortgage)	8	13	18	17	-1	4	9
Mortgage and ABS Sectors							
U.S. Agency RMBS (Pass-throughs)	31	24	34	46	12	22	15
U.S. Agency CMBS	34	44	44	41	-3	-3	7
U.S. Non-Agency CMBS	95	119	148	152	4	33	57
Asset-Backed Securities	38	57	81	75	-6	18	37
Corporate Sectors							
U.S. Investment Grade	92	116	130	155	25	39	63
Industrial	95	116	129	153	24	37	58
Utility	107	127	139	156	17	29	49
Financial Institutions	83	112	130	159	29	47	76
Non-Corporate Credit	55	62	68	72	4	10	17
U.S. High Yield Corporates	283	325	406	569	163	244	286
Emerging Market Debt	581	618	670	835	165	217	254

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total Return	MTD Excess Return	QTD Total Return	QTD Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	-1.57%	-0.60%	-4.69%	-0.88%	-10.35%	-1.41%	6.44
U.S. Gov't/Credit Index	-1.58%	-0.61%	-5.03%	-0.85%	-11.05%	-1.34%	6.73
U.S. Intermediate Gov't/Credit Index	-1.11%	-0.33%	-2.37%	-0.56%	-6.77%	-0.77%	3.96
U.S. 1-3 Yr. Gov't/Credit Index	-0.70%	-0.07%	-0.63%	-0.09%	-3.11%	-0.19%	1.91
U.S. Treasury	-0.88%	0.00%	-3.78%	0.00%	-9.14%	0.00%	6.40
U.S. Agency (Non-Mortgage)	-0.71%	0.08%	-1.86%	-0.08%	-5.98%	-0.53%	3.58
U.S. Agency RMBS (Pass-Throughs)	-1.60%	-0.63%	-4.01%	-0.98%	-8.78%	-1.63%	5.86
CMBS (Commercial Mortgage-Backed Sec.)	-0.76%	0.14%	-2.85%	-0.36%	-8.28%	-0.90%	4.87
ABS (Asset-Backed Securities)	-0.46%	0.21%	-0.91%	-0.11%	-3.77%	-0.41%	2.25
U.S. Corporate Investment Grade	-2.80%	-1.68%	-7.26%	-2.24%	-14.39%	-3.45%	7.57
U.S. High Yield Corporates	-6.73%	-5.91%	-9.83%	-7.92%	-14.19%	-8.44%	4.28
Emerging Market Debt	-7.65%	-6.86%	-12.09%	-9.39%	-17.63%	-10.14%	4.98
Municipal Bond Index	-1.64%	N/A	-2.94%	N/A	-8.98%	N/A	6.79
TIPS (Treasury Inflation Protected Sec.)	-3.16%	0.00%	-6.08%	0.00%	-8.92%	0.00%	6.95

*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

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