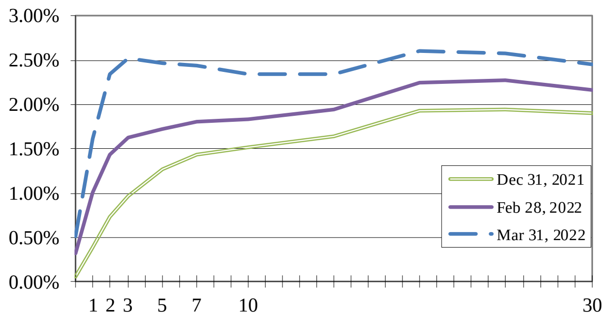
Baird Advisors
Fixed Income Market Commentary
March 2022

Fed Rate Hikes Officially Begin, Treasury Yields Surge in March Capping a Difficult Quarter

Inflation remained a focal point for the Fed and markets in March. The March release of February payrolls showed 678k new jobs, well above survey estimates of 423k. Strong job creation coupled with sub-4% unemployment has pushed YoY wage increases above 5% versus the 2-3% increases generally experienced over the past decade, clear signs of a very tight labor market. The ongoing Russian invasion of Ukraine added to inflationary concerns. Oil prices, which had been on the rise for months, climbed another 9% from the time of invasion on February 21st through quarter-end. As a result, President Biden pledged to release 1mm barrels per day of oil from the strategic petroleum reserves (SPR) in an effort to lower prices. In response to ongoing inflation the Fed concluded its tapering of asset purchases in March and raised its policy rate 25 bps, its first hike since 2018. Chairman Powell underscored that subsequent 50 bps hikes and an earlier start of run-off from the Fed's nearly $9T balance sheet may be necessary to combat inflation in the coming months. Treasury yields rose sharply for 2- and 10-year maturities. Quarterly increases were an outsized 160 and 83 bps, respectively. The curve flattened significantly and ended the quarter with equivalent 2 and 10-year yields. Past yield curve inversions, where 2-year yields exceed those in 10-years, have preceded a slowdown in the US economy, underscoring the delicate balance of policy decisions to curb inflation without leading to a US recession.

Treasury Yields



Maturity	12/31/21	2/28/22	3/31/22	1Mo Chg	Q1 Chg
3 Mo	0.06%	0.32%	0.51%	0.19%	0.45%
1	0.39%	1.01%	1.62%	0.61%	1.23%
2	0.74%	1.44%	2.34%	0.90%	1.60%
3	0.96%	1.63%	2.52%	0.89%	1.56%
5	1.27%	1.72%	2.46%	0.74%	1.19%
7	1.44%	1.81%	2.44%	0.63%	1.00%
10	1.51%	1.83%	2.34%	0.51%	0.83%
30	1.91%	2.17%	2.45%	0.28%	0.54%

Credit Spreads Tighter in March, Wider YTD

By mid-March IG Corporate spreads reached 145 bps before a notable move tighter in the second half of March to end at 116 bps, tighter for the month (-6 bps) but wider for the quarter (+24 bps). Monthly Corporate outperformance was noteworthy given heavy new issuance ($233B - 4th largest month all-time) and continued outflows from IG funds (-$28B). Within Corporates, the bank sector had heavier than expected supply which led to less spread tightening in the March rally (-3 bps) and more YTD widening (+29 bps) compared to other IG sectors despite strong fundamentals. US High Yield and Emerging Markets were tighter for March but remain wider for the year. Agency RMBS appear tighter in Q1 (-7 bps) but widened when excluding the January index prepayment model change. The sector had negative excess returns vs comparable duration Treasuries for the quarter driven by wider spreads and duration extension following a sharp rise in mortgage rates.

Option-Adjusted Spreads (in bps)

	12/31/21	2/28/22	3/31/22	1Mo Chg	Q1 Chg
U.S. Aggregate Index	36	43	41	-2	5
U.S. Agency (non-mortgage)	8	13	13	0	5
Mortgage and ABS Sectors					
U.S. Agency RMBS (Pass-throughs)	31	28	24	-4	-7
U.S. Agency CMBS	34	39	44	5	10
U.S. Non-Agency CMBS	95	120	119	-1	24
Asset-Backed Securities	38	44	57	13	19
Corporate Sectors					
U.S. Investment Grade	92	122	116	-6	24
Industrial	95	124	116	-8	21
Utility	107	136	127	-9	20
Financial Institutions	83	115	112	-3	29
Non-Corporate Credit	55	66	62	-4	7
U.S. High Yield Corporates	283	359	325	-34	42
Emerging Market Debt	581	675	618	-57	37

Source: Bloomberg Indices

Worst Quarterly Aggregate Index Return Since 1980

Bond market returns were negative for all sectors for both the monthly and quarterly periods. March returns for the US Aggregate Index were the worst for any month since July of 2003. ABS declines of only -1.71% for the month and -2.88% for quarterly were largely a function of the sector's shorter duration. Emerging Market Debt declined just -0.18% in March but still fell -6.31% year-to-date due to weakness earlier in the quarter. Municipals (-3.24%) posted the lowest monthly returns.

Total Returns of Selected Bloomberg Indices and Subsectors

	March	Q1	Effective Duration (years)
U.S. Aggregate Index	-2.78%	-5.93%	6.58
U.S. Gov't/Credit Index	-2.85%	-6.33%	7.20
U.S. Intermediate Gov't/Credit Index	-2.45%	-4.51%	4.05
U.S. 1-3 Yr. Gov't/Credit Index	-1.36%	-2.49%	1.92
U.S. Treasury	-3.11%	-5.58%	6.78
U.S. Agency (Non-Mortgage)	-2.35%	-4.20%	3.75
U.S. Agency RMBS (Pass-Throughs)	-2.60%	-4.97%	5.18
CMBS (Commercial Mortgage-Backed Securities)	-2.90%	-5.59%	4.94
ABS (Asset-Backed Securities)	-1.71%	-2.88%	2.28
U.S. Corporate Investment Grade	-2.52%	-7.69%	8.15
U.S. High Yield Corporates	-1.15%	-4.84%	3.94
Emerging Market Debt	-0.18%	-6.31%	5.53
Municipal Bond Index	-3.24%	-6.23%	5.55
TIPS (Treasury Inflation Protected Securities)	-1.86%	-3.02%	7.53

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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