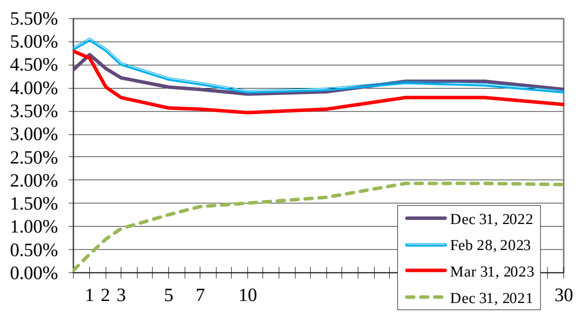
Baird Advisors
Fixed Income Market Commentary
March 2023

Large Market Swings as Fed Forced to Balance Inflation Fight with Financial Stability Concerns

Treasury yields fell in Q1 (10yr: -41 bps), propelled by sharp March declines in the 2yr (-79 bps) and 10yr (-46 bps). March began with the Fed signaling a return to a bigger 50 bps rate hike later in the month and that the terminal rate may need to go higher than previously thought on account of stronger than expected Q1 growth, labor conditions and sticky inflation of 5-6%. The inversion of 2s10s Treasury yields reached -107 bps, the cycle low, following Chair Powell's Congressional testimonial on March 7th/8th citing prospects for prolonged, restrictive Fed policy. Market conditions markedly changed later that week with Silicon Valley Bank's (SVB) failure, created by an abrupt exodus of depositors and outsized balance sheet duration risk. Treasury 2s/10s steepened (to -56 bps at month end) and credit spreads widened. The Fed targeted its response to guarantee SVB deposits (with FDIC and Treasury Dept) and unveiled the Bank Term Funding Program (BTFP) to provide banks access to additional funding. The Fed's balance sheet, which had declined for nearly a year, grew in March to $8.75T (up $350B during the month), due to the response to stress in the banking system, particularly small and mid-sized regional banks. Abroad, Credit Suisse succumbed to negative market sentiment and was absorbed by UBS in a Swiss government facilitated $3.25B transaction to instill bank confidence. Despite prospects of reduced credit availability, the Fed continued its inflation fight with a smaller 25 bps hike to 5%, up 475 bps in the past year. The labor market remained resilient (+311k jobs added in February) supporting the Fed decision to increase rates.

Treasury Yields



Maturity	12/31/21	12/31/22	2/28/23	3/31/23	1 Mo Chg	Q1 Chg
3 Mo	0.06%	4.41%	4.85%	4.80%	-0.05%	0.39%
1	0.39%	4.73%	5.04%	4.65%	-0.39%	-0.08%
2	0.74%	4.43%	4.82%	4.03%	-0.79%	-0.40%
3	0.96%	4.23%	4.53%	3.79%	-0.74%	-0.44%
5	1.27%	4.01%	4.19%	3.58%	-0.61%	-0.43%
7	1.44%	3.97%	4.09%	3.54%	-0.55%	-0.43%
10	1.51%	3.88%	3.93%	3.47%	-0.46%	-0.41%
20	1.94%	4.15%	4.11%	3.80%	-0.31%	-0.35%
30	1.91%	3.97%	3.92%	3.65%	-0.27%	-0.32%

Spreads Notably Wider in March Amid Volatility

IG Corporate spreads began March at +124 and reached +163 mid-month driven by wider bank spreads within financials, before rallying to finish +138, wider for the month (+14 bps) and Q1 (+8 bps). Non-Agency CMBS widened most among US sectors for the month (+60 bps) and Q1 (+36 bps) amid concerns of reduced credit availability from regional banks and lower office occupancy. HY Corporates widened for the month (+43 bps) but remain tighter YTD (-14 bps). EM Debt widened most for the month (+61 bps) and quarter (+44 bps).

Fixed Income Returns Positive in Q1

A strong Treasury rally in March (+2.89%) helped produce positive bond market returns in Q1 (Agg Index +2.96%). The US Corporate index produced negative excess returns in March (-0.42%) but outperformed for the quarter (+0.20%). CMBS and Agency RMBS excess returns were lowest among domestic IG sectors for the month (-1.70% and -1.11%, respectively) and quarter (-0.74% and -0.50%).

Option-Adjusted Spreads (in bps)

	12/31/21	12/31/22	2/28/23	3/31/23	1Mo Chg	Q1 Chg
U.S. Aggregate Index	36	51	48	57	9	6
U.S. Agency (non-mortgage)	8	26	24	28	4	2
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)	31	51	46	63	17	12
U.S. Agency CMBS	34	52	43	62	19	10
U.S. Non-Agency CMBS	95	179	155	215	60	36
Asset-Backed Securities	38	76	57	85	28	9
Corporate Sectors						
U.S. Investment Grade	92	130	124	138	14	8
Industrial	95	125	122	124	2	-1
Utility	107	129	130	136	6	7
Financial Institutions	83	140	126	164	38	24
Non-Corporate Credit	55	66	61	68	7	2
U.S. High Yield Corporates	283	469	412	455	43	-14
Emerging Market Debt	581	687	670	731	61	44

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total Return	MTD Excess Return	Q1 Total Return	Q1 Excess Return	Effective Duration (years)
U.S. Aggregate Index	2.54%	-0.46%	2.96%	-0.09%	6.33
U.S. Gov't/Credit Index	2.82%	-0.17%	3.17%	0.08%	6.55
U.S. Intermediate Gov't/Credit Index	2.30%	-0.18%	2.33%	0.04%	3.85
U.S. 1-3 Yr. Gov't/Credit Index	1.45%	-0.15%	1.51%	-0.08%	1.87
U.S. Treasury	2.89%	0.00%	3.01%	0.00%	6.28
U.S. Agency (Non-Mortgage)	1.92%	-0.16%	2.09%	0.00%	3.23
U.S. Agency RMBS (Pass-Throughs)	1.95%	-1.11%	2.53%	-0.50%	5.93
CMBS (Commercial Mortgage-Backed Sec.)	1.09%	-1.70%	1.81%	-0.74%	4.52
ABS (Asset-Backed Securities)	1.30%	-0.60%	1.86%	-0.05%	2.83
U.S. Corporate Investment Grade	2.78%	-0.42%	3.50%	0.20%	7.25
U.S. High Yield Corporates	1.07%	-1.35%	3.57%	1.23%	3.69
Emerging Market Debt	-0.11%	-2.95%	1.43%	-1.25%	5.01
Municipal Bond Index	2.22%	N/A	2.78%	N/A	6.10
TIPS (Treasury Inflation Protected Sec.)	2.89%	0.00%	3.34%	0.00%	6.88

*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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