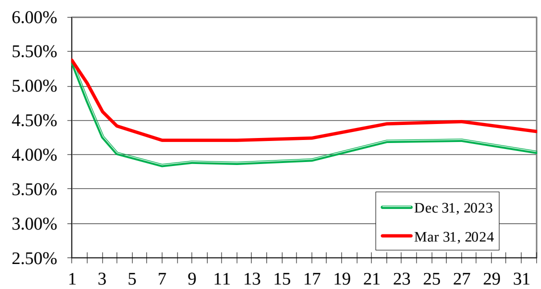
Baird Advisors
Fixed Income Market Commentary
March 2024

Treasury Yields Rise in Q1 as Markets Reduce Fed Rate Cut Expectations on Stronger than Expected Growth and Inflation

The 10yr Treasury yield fell 5 bps in March but ended 32 bps higher for the quarter. The 2s10s yield curve inversion persisted throughout the quarter, stretching to what is now a record 21 months, and ended with -42 bps of inversion. Economic data remained strong, with February payrolls gaining +275k, above the 200k consensus (although the prior two months were revised lower), and inflation, as measured by the Core PCE, easing only slightly, to 2.8% YoY down 0.1% from year end. While Core PCE of 2.8% is down sharply from the 4.8% rate a year ago, it's still too high for the Fed's comfort. In fact, the Fed recently raised its year end inflation outlook to 2.6% from 2.4% and Chairman Powell reiterated the need to see "inflation moving sustainably toward 2%" before cutting. Because of the strong data, market expectations for rate cuts fell during the quarter, down from six at the start of the year to now in line with the Fed's own projection for three cuts in 2024; the first cut is currently expected in June (60% probability), well ahead of the November election. Outside the US, the Bank of Japan ended its historic negative rate policy, raising the target on their policy rate by 20 bps to a 0-0.1% range. Importantly, this also ends the era of negative yielding debt, which in late-2020 exceeded $18 trillion.

Treasury Yields



Maturity	12/31/22	12/31/23	2/29/24	3/31/24	1 Mo Chg	Q1 Chg
3 Mo	4.41%	5.36%	5.39%	5.38%	-0.01%	0.02%
1	4.73%	4.78%	5.01%	5.04%	0.03%	0.26%
2	4.43%	4.25%	4.62%	4.62%	0.00%	0.37%
3	4.23%	4.01%	4.42%	4.41%	-0.01%	0.40%
5	4.01%	3.85%	4.25%	4.21%	-0.04%	0.36%
7	3.97%	3.88%	4.27%	4.21%	-0.06%	0.33%
10	3.88%	3.88%	4.25%	4.20%	-0.05%	0.32%
20	4.15%	4.20%	4.52%	4.45%	-0.07%	0.25%
30	3.97%	4.03%	4.38%	4.35%	-0.03%	0.32%

IG Corporate Spreads Tighten Despite Record Issuance

Despite record Q1 issuance (prior record issuance Q1 '20), IG corporate spreads tightened -6 bps for the month and -9 bps for the quarter, led by Financials which tightened -7 bps and -16 bps for the month and quarter, respectively. Non-Agency CMBS tightened -8 bps in March and -51 bps for the quarter, led by the lowest rated segments (BBB rated CMBS tightened -220 bps for the quarter while AAA rated CMBS tightened -38 during that same period). US High Yield and EM Debt both tightened in March and quarter, ending the quarter -24 bps and -71 bps tighter, respectively.

Option-Adjusted Spreads (in bps)

	12/31/22	12/31/23	2/29/24	3/31/24	1Mo Chg	Q1 Chg
U.S. Aggregate Index	51	42	41	39	-2	-3
U.S. Agency (non-mortgage)	26	17	12	15	3	-2
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)	51	47	51	49	-2	2
U.S. Agency CMBS	52	48	44	41	-3	-7
U.S. Non-Agency CMBS	179	203	160	152	-8	-51
Asset-Backed Securities	76	68	55	55	0	-13
Corporate Sectors						
U.S. Investment Grade	130	99	96	90	-6	-9
Industrial	125	90	91	85	-6	-5
Utility	129	105	102	97	-5	-8
Financial Institutions	140	112	103	96	-7	-16
Non-Corporate Credit	66	55	52	53	1	-2
U.S. High Yield Corporates	469	323	312	299	-13	-24
Emerging Market Debt	687	598	556	527	-29	-71

Source: Bloomberg Indices

Positive March Returns Reduce YTD Declines

The Agg Index followed declines in January and February by returning +0.92% in March bringing the YTD return to -0.78% (+0.23% YTD excess return) as Treasury yields fell slightly in March, but rose for the quarter. Agy RMBS was the sole taxable IG subsector with negative excess returns YTD (-0.14%) although buoyed by positive excess return of +0.34% in March. Subsectors with highest YTD excess returns include EM Debt (+5.33%), US High Yield (+1.59%), CMBS (+1.45%) and IG Corporates (+0.89%).

Total Returns of Selected Bloomberg Indices and Subsectors

	Mar Total Return	Mar Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	0.92%	0.24%	-0.78%	0.23%	6.21
U.S. Gov't/Credit Index	0.88%	0.21%	-0.72%	0.34%	6.33
U.S. Intermediate Gov't/Credit Index	0.64%	0.14%	-0.15%	0.22%	3.77
U.S. 1-3 Yr. Gov't/Credit Index	0.40%	0.04%	0.42%	0.09%	1.84
U.S. Treasury	0.64%	0.00%	-0.96%	0.00%	6.04
U.S. Agency (Non-Mortgage)	0.46%	-0.01%	0.08%	0.14%	3.18
U.S. Agency RMBS (Pass-Throughs)	1.06%	0.34%	-1.04%	-0.14%	6.08
CMBS (Commercial Mortgage Backed Securities)	0.91%	0.37%	0.85%	1.45%	4.32
ABS (Asset-Backed Securities)	0.49%	0.06%	0.68%	0.54%	2.63
U.S. Corporate Investment Grade	1.29%	0.56%	-0.40%	0.89%	7.01
U.S. High Yield Corporates	1.18%	0.71%	1.47%	1.59%	3.15
Emerging Market Debt	2.78%	2.17%	4.71%	5.33%	4.92
Municipal Bond Index	0.00%	N/A	-0.39%	N/A	6.07
Taxable Municipal Bond: Agg Eligible	1.20%	0.27%	-0.44%	1.53%	9.34
TIPS (Treasury Inflation Protected Securities)	0.82%	0.00%	-0.08%	0.00%	6.73

*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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