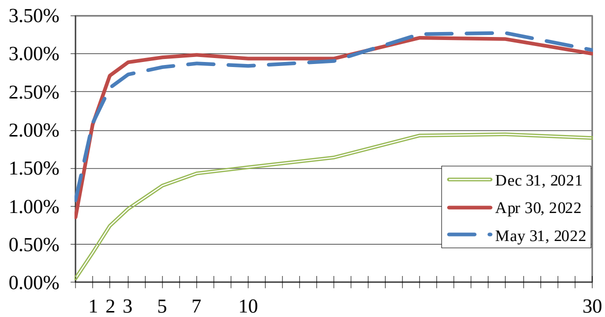
Baird Advisors
Fixed Income Market Commentary
May 2022

Investment Grade Bond Prices Rise as Fed Tightening Cools Economic Data

The 10Y Treasury yield declined 9 bps, its first monthly decline in 2022. Investors found the yield and high-quality of Treasuries attractive in the face of economic uncertainty. As expected, the Fed raised its policy rate 50 bps in early May. Meeting minutes underscored a desire for similar 50 bps rate hikes over the next two meetings as well as allowing its Treasury and mortgage holdings to roll off beginning in June. Chairman Powell reiterated the Fed's desire to tighten until "clear and convincing" data emerges showing inflation abating. Inflation moved in the Fed's desired direction as YoY core PCE for April fell to 4.91% from 5.20% in March. Headline CPI also fell to 8.26% from the prior month high of 8.54%, but still well above Fed targets and expectations. Treasury prices rose as a haven investment on the climbing possibility of a recession. April new home sales posted a decline of 16.6% and University of Michigan consumer sentiment reached a cycle-low reading of 58.4 as individuals faced elevated borrowing costs and prices for goods and services. Market volatility remained elevated, particularly among stocks and lower-quality fixed income, as investors assessed the Fed's ability to fight inflation without causing a recession. Following a historically weak 4-month period in the US bond market, elevated yields attracted investors and reduced fund outflows, particularly in the second half of May.

Treasury Yields



Maturity	12/31/21	4/30/22	5/31/22	1Mo Chg	YTD Chg
3 Mo	0.06%	0.85%	1.08%	0.23%	1.02%
1	0.39%	2.08%	2.08%	0.00%	1.69%
2	0.74%	2.72%	2.56%	-0.16%	1.82%
3	0.96%	2.89%	2.73%	-0.16%	1.77%
5	1.27%	2.96%	2.82%	-0.14%	1.55%
7	1.44%	2.99%	2.88%	-0.11%	1.44%
10	1.51%	2.94%	2.85%	-0.09%	1.34%
30	1.91%	3.00%	3.05%	0.05%	1.14%

Corporate Spreads Tighten Despite May Volatility

IG Corporate spreads widened during the first three weeks of May and reached a YTD high of 149 bps before a subsequent 19 bps rally unfolded in the final 6 trading days of the month. Agency RMBS and CMBS both tightened in May while Non-Agency CMBS and ABS widened, reversing April's outperformance. HY Corporate and EM Debt spreads each moved wider for the month, continuing their YTD trends.

First Positive Monthly Returns in 2022 for the US Agg

The Aggregate Index returned 0.64% in May. Agency RMBS provided the strongest subsector returns (+1.11%) and second highest monthly excess returns (+0.70%), recovering some of April's underperformance. Returns were positive for both CMBS and ABS, but both sectors underperformed like-duration Treasuries. IG Corporate Bonds produced the highest excess returns in May. Municipals generated the largest nominal returns in May, offsetting some prior month underperformance. TIPS produced the lowest monthly returns as inflation expectations shifted lower.

Option-Adjusted Spreads (in bps)

	12/31/21	4/30/22	5/31/22	1Mo Chg	YTD Chg
U.S. Aggregate Index	36	49	46	-3	10
U.S. Agency (non-mortgage)	8	14	18	4	10
Mortgage and ABS Sectors					
U.S. Agency RMBS (Pass-throughs)	31	40	34	-6	3
U.S. Agency CMBS	34	46	44	-2	10
U.S. Non-Agency CMBS	95	121	148	27	53
Asset-Backed Securities	38	69	81	12	43
Corporate Sectors					
U.S. Investment Grade	92	135	130	-5	38
Industrial	95	134	129	-5	34
Utility	107	141	139	-2	32
Financial Institutions	83	133	130	-3	47
Non-Corporate Credit	55	67	68	1	13
U.S. High Yield Corporates	283	379	406	27	123
Emerging Market Debt	581	646	670	24	89

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total Return	MTD Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	0.64%	0.39%	-8.92%	-0.87%	6.51
U.S. Gov't/Credit Index	0.48%	0.29%	-9.62%	-0.79%	6.86
U.S. Intermediate Gov't/Credit Index	0.74%	0.08%	-5.72%	-0.46%	4.01
U.S. 1-3 Yr. Gov't/Credit Index	0.61%	0.04%	-2.42%	-0.12%	1.93
U.S. Treasury	0.18%	0.00%	-8.33%	0.00%	6.47
U.S. Agency (Non-Mortgage)	0.49%	-0.06%	-5.31%	-0.61%	3.63
U.S. Agency RMBS (Pass-Throughs)	1.11%	0.70%	-7.29%	-1.05%	5.82
CMBS (Commercial Mortgage-Backed Securities)	0.21%	-0.46%	-7.58%	-1.04%	4.88
ABS (Asset-Backed Securities)	0.31%	-0.26%	-3.32%	-0.62%	2.26
U.S. Corporate Investment Grade	0.93%	0.79%	-11.92%	-1.99%	7.77
U.S. High Yield Corporates	0.25%	-0.35%	-8.00%	-3.02%	4.16
Emerging Market Debt	-0.88%	-1.50%	-10.81%	-4.05%	5.33
Municipal Bond Index	1.49%	N/A	-7.47%	N/A	6.10
TIPS (Treasury Inflation Protected Securities)	-0.99%	0.00%	-5.95%	0.00%	7.24

*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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