Baird Advisors
Fixed Income Market Commentary
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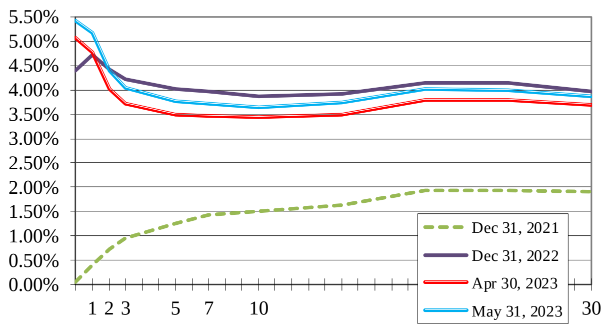
Treasury Yields Climb on Resilient Economic Data, Fading Regional Bank Concerns and Debt Ceiling Uncertainty

Treasury yields were rangebound in early May as the Fed delivered the expected 25 bps Fed rate hike. As the month progressed, however, yields climbed on resilient economic data, a reversal of risk aversion as concerns over regional banks faded and some reluctance to buy Treasuries, especially abroad, given debt ceiling/default uncertainty. The 10yr Treasury yield increased 22 bps in May but was up as much as 39 bps intra-month. The market materially impacted by the debt ceiling debate to avoid default was the short Treasury Bills market. Especially impacted were early June/July maturities, the window including the X-date of a default in the extremely unlikely event the debt ceiling wasn't raised. The yield on the Treasury Bill maturing on June 8th rose over 200 bps during the month to 7.05% only to end the month at 5.23% as the Fiscal Responsibility Act of 2023 (FRA) to raise the debt ceiling was approved by the House on the 31st. Economic impacts of spending cuts in the FRA are forecasted to reduce growth by roughly 30 bps in fiscal year 2024. Treasury yields also remained influenced by economic and Fed policy expectations. While the May Fed Funds hike was unanimous, meeting minutes noted a split among voting members regarding additional hikes as "tighter credit conditions for households and businesses are likely to weigh on economic activity, hiring and inflation." Although a pause in rate hikes in June wouldn't necessarily mean an end to the cycle, Fed Chair Powell recently acknowledged that credit stresses could lower the ultimate peak rate level. Conversely, the labor market remains strong. The May release of payroll data at 253k jobs exceeded market expectations, as has been the case over the past year. Additionally, the Core PCE Index, the Fed's preferred inflation gauge, remains at 4.70%, largely where it began 2023, well above the Fed's 2% target.

Treasury Yields



Maturity	12/31/21	12/31/22	4/30/23	5/31/23	1 Mo Chg	YTD Chg
3 Mo	0.06%	4.41%	5.08%	5.42%	0.34%	1.01%
1	0.39%	4.73%	4.78%	5.18%	0.40%	0.45%
2	0.74%	4.43%	4.01%	4.41%	0.40%	-0.02%
3	0.96%	4.23%	3.72%	4.05%	0.33%	-0.18%
5	1.27%	4.01%	3.49%	3.76%	0.27%	-0.25%
7	1.44%	3.97%	3.47%	3.71%	0.24%	-0.26%
10	1.51%	3.88%	3.43%	3.65%	0.22%	-0.23%
20	1.94%	4.15%	3.80%	4.02%	0.22%	-0.13%
30	1.91%	3.97%	3.68%	3.86%	0.18%	-0.11%

Corporate Supply Widens Spreads, Agency RMBS Tightens

IG Corporate spreads widened just 2 bps despite elevated issuance. The Financial subsector outperformed but remains wide (+157 bps) historically vs Industrials. Agency RMBS, having successfully navigated the onset of FDIC failed-bank balance sheet liquidations, tightened 10 bps and now sits only 5 bps wide to where it began 2023. Non-Agency CMBS spreads widened again (+2 bps). Spreads of +212 bps are outsized in large part due to BBB underperformance (+324 bps wider YTD) as opposed to AAA (+22 bps wider).

Fixed Income Returns Negative as Yields Rise in Late May

The US Agg Index returned -1.09% in May but remains positive YTD (+2.46%). Agency RMBS rebounded following April's weakness to lead US sectors in excess returns (+0.41%) in May. IG Corporate excess returns were lowest in May among IG sectors (-0.08%) but remain strongest YTD (+0.31%). Among major sectors, HY Corporate debt had the lowest May excess return (-0.22%) but remains an outperformer YTD (+1.49%). TIPS declined -1.2% in May.

Option-Adjusted Spreads (in bps)

	12/31/21	12/31/22	4/30/23	5/31/23	1Mo Chg	YTD Chg
U.S. Aggregate Index	36	51	57	55	-2	4
U.S. Agency (non-mortgage)	8	26	28	23	-5	-3
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)	31	51	66	56	-10	5
U.S. Agency CMBS	34	52	63	55	-8	3
U.S. Non-Agency CMBS	95	179	210	212	2	33
Asset-Backed Securities	38	76	83	79	-4	3
Corporate Sectors						
U.S. Investment Grade	92	130	136	138	2	8
Industrial	95	125	124	127	3	2
Utility	107	129	133	140	7	11
Financial Institutions	83	140	157	157	0	17
Non-Corporate Credit	55	66	64	63	-1	-3
U.S. High Yield Corporates	283	469	452	459	7	-10
Emerging Market Debt	581	687	748	747	-1	60

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	-1.09%	0.10%	2.46%	0.06%	6.34
U.S. Gov't/Credit Index	-1.24%	-0.02%	2.53%	0.15%	6.48
U.S. Intermediate Gov't/Credit Index	-0.74%	0.03%	2.19%	0.14%	3.84
U.S. 1-3 Yr. Gov't/Credit Index	-0.31%	0.03%	1.54%	0.02%	1.87
U.S. Treasury	-1.16%	0.00%	2.35%	0.00%	6.23
U.S. Agency (Non-Mortgage)	-0.37%	0.20%	2.13%	0.21%	3.14
U.S. Agency RMBS (Pass-Throughs)	-0.73%	0.41%	2.30%	-0.17%	6.15
CMBS (Commercial Mortgage Backed Securities)	-0.61%	0.32%	2.06%	-0.15%	4.51
ABS (Asset-Backed Securities)	-0.34%	0.17%	2.02%	0.29%	2.81
U.S. Corporate Investment Grade	-1.45%	-0.08%	2.78%	0.31%	7.14
U.S. High Yield Corporates	-0.92%	-0.22%	3.64%	1.49%	3.59
Emerging Market Debt	-0.50%	0.47%	-0.02%	-2.32%	4.91
Municipal Bond Index	-0.87%	N/A	1.65%	N/A	6.08
TIPS (Treasury Inflation Protected Securities)	-1.20%	0.00%	2.21%	0.00%	6.79

*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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