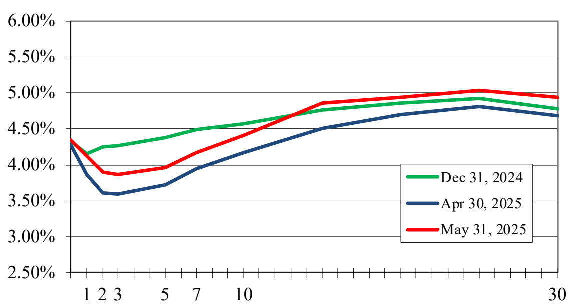
Baird Advisors
Fixed Income Market Commentary
May 2025

Yields Rise, US Treasury Downgraded and Fed Holds as Trade Tensions Persist

Treasury yields shifted higher in May with all maturities rising 23-29 bps. The curve flattened slightly as the 2s10s slope fell 4 bps to +51 bps. The upward move in yields during May began with the April payroll report of +177k jobs, above expectations of +138k, even as the unemployment rate held at 4.2%. Not surprisingly, the Fed held its policy rate steady at 4.25-4.50% at its May FOMC meeting, preferring to “wait and see” the impact of various fiscal and trade proposals. Yet, inflation moved toward the Fed’s target level as the PCE Price index rose just 2.1% YoY and Core PCE fell to 2.5% from 2.7% YoY, its slowest annual gain in more than 4 years. Moody’s downgraded US Treasuries one notch to Aa1 from Aaa, matching prior moves from S&P (2011) and Fitch (2023). Moody’s cited persistent deficits without credible containment plans, rising debt to GDP and deteriorating comparative metrics to other sovereigns. Demand for Treasuries cooled as the 20yr auction exhibited weakness, clearing at over 5% yield, the highest level for a 20yr auction since 2023. Shifting trade policies challenged economic forecasters as China was added to the 90-day reciprocal tariff pause in another de-escalation move, only to have the EU threatened with a 40% tariff increase if they didn’t show urgency in negotiating a trade deal. The Court of International Trade blocked some of the President’s tariffs, but they were reinstated the same day as appeals began. Finally, the tax policy focused “Big Beautiful Bill” passed the House and moves to the Senate for further debate and modification.

Treasury Yields



Maturity	12/31/23	12/31/24	4/30/25	5/31/25	1 Mo Chg	YTD Chg
3 Mo	5.36%	4.33%	4.29%	4.35%	0.06%	0.02%
1	4.78%	4.16%	3.86%	4.12%	0.26%	-0.04%
2	4.25%	4.24%	3.61%	3.90%	0.29%	-0.34%
3	4.01%	4.28%	3.60%	3.87%	0.27%	-0.41%
5	3.85%	4.38%	3.73%	3.96%	0.23%	-0.42%
7	3.88%	4.48%	3.94%	4.18%	0.24%	-0.30%
10	3.88%	4.58%	4.16%	4.41%	0.25%	-0.17%
20	4.20%	4.86%	4.70%	4.94%	0.24%	0.08%
30	4.03%	4.78%	4.68%	4.93%	0.25%	0.15%

Spreads Tighten in May, Reversing April Widening

IG Corporate spreads compressed by a notable 18 bps in May amid further tariff de-escalation to finish the month at +88. Spreads have moved -31 bps tighter since April’s peak OAS for 2025 of +119 and now reside just +8 bps wider YTD despite trade and fiscal policy induced volatility. Mortgage and ABS sector spreads also tightened, led by non-Agy CMBS (-14 bps) and ABS (-14 bps).

Excess Returns Broadly Positive in May

The Agg Index total return was negative in May (-0.72%) as Treasury yields rose, but excess returns were positive (+0.38%) as spreads compressed across market sectors. Among investment grade sectors, IG Corporate (+1.27%) and CMBS (+0.46%) provided the highest excess returns. Lower quality market segments, as shown by HY Corporate and EM Debt, produced higher levels of total return and excess return (+2.14% and +2.59% excess return, respectively).

Option-Adjusted Spreads (in bps)

	12/31/23	12/31/24	4/30/25	5/31/25	1 Mo Chg	YTD Chg
U.S. Aggregate Index	42	34	40	34	-6	0
U.S. Agency (non-mortgage)	17	12	12	9	-3	-3
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)*	47	43	43	42	-1	*8
U.S. Agency CMBS	48	35	43	37	-6	2
U.S. Non-Agency CMBS	203	127	152	138	-14	11
Asset-Backed Securities	68	44	74	60	-14	16
Corporate Sectors						
U.S. Investment Grade	99	80	106	88	-18	8
Industrial	90	78	104	85	-19	7
Utility	105	82	112	97	-15	15
Financial Institutions	112	82	108	90	-18	8
Non-Corporate Credit	55	55	59	52	-7	-3
U.S. High Yield Corporates	323	287	384	315	-69	28
Emerging Market Debt	598	393	462	407	-55	14

Source: Bloomberg Indices
*Bloomberg updated U.S. Agency RMBS (Pass-Throughs) prepayment model effective 1/24/25.
Adjusting to the new model, U.S. Agency RMBS (Pass-Throughs) 12/31/24 OAS would be 34; 2025 spread changes reflect the adjusted 12/31/24 OAS.

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total Return	MTD Excess Return	3 Mo Total Return	3 Mo Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	-0.72%	0.38%	-0.29%	-0.05%	2.45%	-0.10%	6.06
U.S. Gov’t/Credit Index	-0.66%	0.44%	-0.20%	0.09%	2.44%	-0.04%	6.10
U.S. Intermediate Gov’t/Credit Index	-0.33%	0.28%	1.04%	0.08%	3.03%	0.06%	3.76
U.S. 1-3 Yr. Gov’t/Credit Index	-0.13%	0.09%	1.09%	0.04%	2.26%	0.08%	1.88
U.S. Treasury	-1.03%	0.00%	-0.17%	0.00%	2.51%	0.00%	5.82
U.S. Agency (Non-Mortgage)	-0.31%	0.18%	0.69%	-0.01%	2.52%	0.12%	3.29
U.S. Agency RMBS (Pass-Throughs)	-0.91%	0.19%	-0.65%	-0.46%	2.41%	-0.27%	6.15
CMBS (Commercial Mortgage Backed Securities)	-0.26%	0.46%	0.91%	-0.03%	3.23%	0.16%	4.00
ABS (Asset-Backed Securities)	0.02%	0.38%	0.74%	-0.03%	2.05%	-0.14%	2.63
U.S. Corporate Investment Grade	-0.01%	1.27%	-0.33%	0.23%	2.26%	-0.18%	6.76
U.S. High Yield Corporates	1.68%	2.14%	0.62%	-0.39%	2.68%	0.02%	2.92
Emerging Market Debt	1.74%	2.59%	0.66%	0.38%	3.06%	0.37%	4.86
Municipal Bond Index	0.06%	N/A	-2.42%	N/A	-0.96%	N/A	6.70
Taxable Municipal Bond: Agg Eligible	-1.48%	0.29%	-2.37%	-0.82%	1.11%	-1.19%	9.02
TIPS (Treasury Inflation Protected Securities)	-0.59%	0.00%	0.17%	0.00%	3.68%	0.00%	6.59

*Excess return represents the return of a spread sector versus a like-duration U.S. Treasury.

Disclosures

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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.

Treasury yields are the interest rates that the U.S. government pays to borrow money for varying periods of time.

Option-adjusted spread is the difference between the yield of a security that pays fixed interest payments and the current U.S. Treasury rates, which represents the rate of return on a risk-free investment.

Indices are unmanaged, and are not available for direct investment.

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.