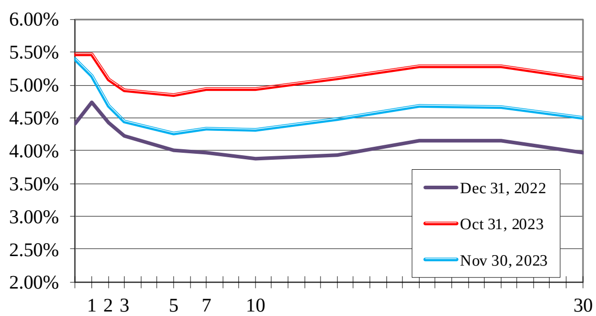
# Baird Advisors
# Fixed Income Market Commentary
# November 2023

## Treasury Yields Decline Sharply on Market Hopes for 2024 Rate Cuts and Economic Soft Landing

After climbing for six consecutive months, the 10yr Treasury yield fell 60 bps in November, ending at 4.33%. Several factors contributed to the sharp market rally. First, as expected, the Fed held its policy rate steady at 5.50% at the November FOMC meeting, but Chairman Powell followed with more dovish than expected comments in the press conference. He noted that the risks of over- versus under-tightening were now more balanced. Second, the job market supported the rally as nonfarm payrolls rose just 150k (est. 180k) with downward revisions to prior months. The unemployment rate rose 0.1% to 3.9%, which is now up 0.5% from the January low. Inflation continued its gradual downward path as the CPI rate declined to 3.2% YoY and Core PCE, the Fed's preferred measure, softened to 3.5% YoY. Next, the US Treasury Department altered their quarterly refunding allocation in a market friendly way. They trimmed expected longer-term supply in favor of T-bills, which further fueled the rally in long-term Treasury prices. Yet, Moody's placed the US government's Aaa rating on a negative outlook due to higher debt service costs and growing deficits. Congress passed a Continuing Resolution to avoid a shutdown, funding the government through January 19. Finally, investor anxiety over global events eased modestly last month following the meeting of Presidents Biden and Xi Jinping from China and a temporary pause in fighting in the Israel/Hamas conflict.

**Treasury Yields**




| Maturity | 12/31/22 | 10/31/23 | 11/30/23 | 1 Mo Chg | YTD Chg |
|---|---|---|---|---|---|
| 3 Mo | 4.41% | 5.48% | 5.40% | -0.08% | 0.99% |
| 1 | 4.73% | 5.47% | 5.14% | -0.33% | 0.41% |
| 2 | 4.43% | 5.09% | 4.68% | -0.41% | 0.25% |
| 3 | 4.23% | 4.93% | 4.45% | -0.48% | 0.22% |
| 5 | 4.01% | 4.86% | 4.27% | -0.59% | 0.26% |
| 7 | 3.97% | 4.94% | 4.34% | -0.60% | 0.37% |
| 10 | 3.88% | 4.93% | 4.33% | -0.60% | 0.45% |
| 20 | 4.15% | 5.29% | 4.68% | -0.61% | 0.53% |
| 30 | 3.97% | 5.10% | 4.50% | -0.60% | 0.53% |

## Spreads Notably Tighter in November

US Agency RMBS spreads tightened -19 bps, reversing nearly all their outsized widening in September and October. IG Corporate spreads tightened -25 bps in November making YTD spread -26 bps tighter. The +104 bps spread level is the tightest since January 2022. Within Corporate debt the Financial sector remains widest at +123 bps and tightened most for the month, -29 bps. Non-Agy CMBS tightened -4 bps in November but remains +33 bps wider YTD due to underperformance of lower-rated CMBS.

## Agg Monthly Return Highest Since July 1984

The US Agg Index rose 4.53% in November, bringing YTD results back into positive territory at 1.64%. YTD returns for all major bond sectors were positive by month end. Agy RMBS rebounded from a string of weak months to return 5.21%, its strongest monthly performance since July 1982. US IG Corporates retuned nearly 6% in November with 2.05% of excess returns. Municipals returned an outsized 6.35% in November, besting all major bond sectors, following a difficult September and October.

**Option-Adjusted Spreads (in bps)**

| | 12/31/22 | 10/31/23 | 11/30/23 | 1Mo Chg | YTD Chg |
|---|---|---|---|---|---|
| U.S. Aggregate Index | 51 | 57 | 45 | -12 | -6 |
| U.S. Agency (non-mortgage) | 26 | 16 | 15 | -1 | -11 |
| Mortgage and ABS Sectors | | | | | |
| U.S. Agency RMBS (Pass-throughs) | 51 | 75 | 56 | -19 | 5 |
| U.S. Agency CMBS | 52 | 61 | 54 | -7 | 2 |
| U.S. Non-Agency CMBS | 179 | 216 | 212 | -4 | 33 |
| Asset-Backed Securities | 76 | 79 | 78 | -1 | 2 |
| Corporate Sectors | | | | | |
| U.S. Investment Grade | 130 | 129 | 104 | -25 | -26 |
| Industrial | 125 | 116 | 92 | -24 | -33 |
| Utility | 129 | 129 | 111 | -18 | -18 |
| Financial Institutions | 140 | 152 | 123 | -29 | -17 |
| Non-Corporate Credit | 66 | 57 | 53 | -4 | -13 |
| U.S. High Yield Corporates | 469 | 437 | 370 | -67 | -99 |
| Emerging Market Debt | 687 | 676 | 625 | -51 | -62 |

*Source: Bloomberg Indices*

**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 | 4.53% | 0.89% | 0.26% | 0.37% | 1.64% | 1.10% | 6.19 |
| U.S. Gov't/Credit Index | 4.33% | 0.73% | 0.44% | 0.59% | 1.97% | 1.53% | 6.24 |
| U.S. Intermediate Gov't/Credit Index | 2.67% | 0.42% | 1.09% | 0.23% | 2.86% | 0.77% | 3.77 |
| U.S. 1-3 Yr. Gov't/Credit Index | 1.16% | 0.13% | 1.43% | 0.06% | 3.38% | 0.20% | 1.85 |
| U.S. Treasury | 3.47% | 0.00% | -0.04% | 0.00% | 0.67% | 0.00% | 5.97 |
| U.S. Agency (Non-Mortgage) | 1.93% | 0.10% | 1.12% | 0.12% | 3.17% | 0.56% | 3.14 |
| U.S. Agency RMBS (Pass-Throughs) | 5.21% | 1.33% | -0.24% | -0.21% | 0.71% | 0.03% | 6.23 |
| CMBS (Commercial Mortgage Backed Securities) | 3.06% | 0.46% | 0.94% | 0.24% | 2.32% | 0.58% | 4.38 |
| ABS (Asset-Backed Securities) | 1.71% | 0.23% | 1.10% | 0.02% | 3.56% | 0.87% | 2.65 |
| U.S. Corporate Investment Grade | 5.98% | 2.05% | 1.22% | 1.66% | 4.01% | 4.07% | 6.90 |
| U.S. High Yield Corporates | 4.53% | 2.40% | 2.09% | 1.04% | 9.37% | 6.78% | 3.37 |
| Emerging Market Debt | 6.04% | 3.27% | 3.15% | 3.32% | 8.35% | 7.61% | 4.81 |
| Municipal Bond Index | 6.35% | N/A | 2.35% | N/A | 3.98% | N/A | 6.18 |
| Taxable Municipal Bond: Agg Eligible | 5.87% | 0.42% | -0.76% | 0.73% | 2.87% | 4.62% | 9.33 |
| TIPS (Treasury Inflation Protected Securities) | 2.71% | 0.00% | 0.08% | 0.00% | 1.17% | 0.00% | 6.54 |

*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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