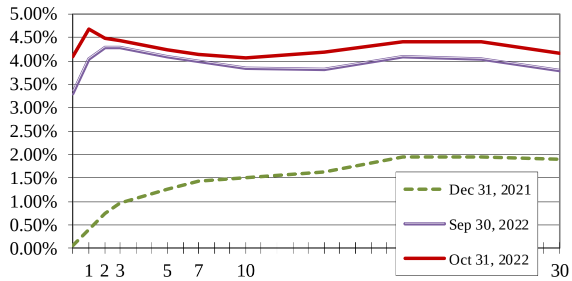
Baird Advisors
Fixed Income Market Commentary
October 2022

Treasury Yields Climb Further as the Prospect for Additional Tightening Remains Intact

Yields rose across the Treasury curve, with the 10yr touching a new YTD high intra-month at 4.24% before falling back to 4.05% at month end, up 21 bps in October. The 2yr yield also rose 21 bps in the month, leaving the 2s10s curve inversion intact at -44 bps. As expected, reported headline inflation for September slipped to 8.20% YoY on lower gasoline prices (down from the 9.06% June peak) but it still exceeded consensus forecasts. Core CPI (ex-food & energy), however, continued to rise, reaching a new 40-year high of 6.6% YoY as increases in housing and medical costs influenced the reading. Bringing down inflation has proven to be a difficult task for the Fed as the economy has remained resilient and job creation has remained strong despite the aggressive path of rate hikes the Fed has implemented since March. In October, we received a solid 3Q GDP report of 2.6%, above market expectations, and monthly job growth remained strong in September with 263k net new jobs created. Yet, market volatility remained elevated as investors grappled with other mixed economic signals (i.e. softening consumer sentiment and ISM manufacturing surveys) and the uncertainty surrounding the mid-term elections. Fixed income fund outflows remained negative in October with YTD net redemptions of $298B (as of the week ending 10/24). Across the pond, the European Central Bank raised rates by 75 bps once again (to 1.50%) to fight inflation, while the Bank of England, seeking to calm its sovereign debt volatility, continued last month's emergency measure to buy Gilts and postponed its monetary tightening until November.

Treasury Yields



Maturity	12/31/21	9/30/22	10/31/22	1Mo Chg	YTD Chg
3 Mo	0.06%	3.29%	4.09%	0.80%	4.03%
1	0.39%	4.05%	4.67%	0.62%	4.28%
2	0.74%	4.28%	4.49%	0.21%	3.75%
3	0.96%	4.29%	4.44%	0.15%	3.48%
5	1.27%	4.09%	4.23%	0.14%	2.96%
7	1.44%	3.99%	4.15%	0.16%	2.71%
10	1.51%	3.84%	4.05%	0.21%	2.54%
20	1.94%	4.09%	4.41%	0.32%	2.47%
30	1.91%	3.78%	4.17%	0.39%	2.26%

IG Corporate Spreads Reach 2022 High

IG Corporate spreads widened to +165 mid-month before rallying to close October at +158, tighter (-1 bps) on the month. Financial subsector spreads widened +11 bps on continued elevated issuance. Agency RMBS, CMBS and ABS all widened during the month. Agency RMBS spreads reached +88 before finishing the month +73 bps continuing the recent trend of higher spread volatility for this sector. High Yield Corporate debt tightened -88 bps in sympathy with the bounce in stock prices. EM debt tightened -10 bps in October but remains an outsized +233 bps wider YTD.

CMBS/ABS Underperform Following Agency RMBS

CMBS and ABS sectors underperformed other sectors on an excess returns basis in a lagged response to recent cheapening in Agency RMBS and elevated selling of these higher rated, more liquid sectors in response to continued industry outflows. Agency RMBS excess returns remained negative for the third consecutive month. IG Corporate returns were negative (-1.03%) but offered excess returns of +0.60% vs comparable duration Treasuries driven by outperformance of longer maturity corporates. Nominal (+2.60%) and excess (+3.07%) returns were highest for High Yield Corporates. TIPs were one of only three major sectors with positive returns in October (+1.24%).

Option-Adjusted Spreads (in bps)

	12/31/21	9/30/22	10/31/22	1Mo Chg	YTD Chg
U.S. Aggregate Index	36	62	65	3	29
U.S. Agency (non-mortgage)	8	15	26	11	18
Mortgage and ABS Sectors					
U.S. Agency RMBS (Pass-throughs)	31	69	73	4	42
U.S. Agency CMBS	34	48	66	18	32
U.S. Non-Agency CMBS	95	154	190	36	95
Asset-Backed Securities	38	53	95	42	57
Corporate Sectors					
U.S. Investment Grade	92	159	158	-1	66
Industrial	95	155	148	-7	53
Utility	107	158	155	-3	48
Financial Institutions	83	166	177	11	94
Non-Corporate Credit	55	73	76	3	21
U.S. High Yield Corporates	283	552	464	-88	181
Emerging Market Debt	581	824	814	-10	233

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total Return	MTD Excess Return	QTD Total Return	QTD Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	-1.30%	0.04%	-8.23%	-1.07%	-15.72%	-1.80%	6.11
U.S. Gov't/Credit Index	-1.24%	0.20%	-7.74%	-0.28%	-16.15%	-1.21%	6.22
U.S. Intermediate Gov't/Credit Index	-0.44%	0.01%	-5.04%	-0.20%	-10.02%	-0.72%	3.83
U.S. 1-3 Yr. Gov't/Credit Index	-0.13%	-0.04%	-2.11%	-0.11%	-4.66%	-0.21%	1.87
U.S. Treasury	-1.39%	0.00%	-7.16%	0.00%	-14.30%	0.00%	5.93
U.S. Agency (Non-Mortgage)	-0.76%	-0.33%	-4.46%	-0.51%	-9.21%	-1.02%	3.35
U.S. Agency RMBS (Pass-Throughs)	-1.42%	-0.29%	-9.60%	-3.05%	-14.89%	-3.32%	5.99
CMBS (Commercial Mortgage-Backed Sec.)	-1.60%	-1.01%	-7.09%	-1.19%	-13.23%	-1.99%	4.64
ABS (Asset-Backed Securities)	-0.84%	-0.72%	-2.64%	-0.31%	-5.85%	-0.80%	2.76
U.S. Corporate Investment Grade	-1.03%	0.60%	-8.98%	-0.73%	-19.56%	-3.02%	6.96
U.S. High Yield Corporates	2.60%	3.07%	-3.75%	1.12%	-12.53%	-3.59%	4.00
Emerging Market Debt	0.72%	1.56%	-4.41%	1.89%	-19.91%	-8.10%	4.86
Municipal Bond Index	-0.83%	N/A	-6.73%	N/A	-12.86%	N/A	7.34
TIPS (Treasury Inflation Protected Sec.)	1.24%	0.00%	-7.97%	0.00%	-12.54%	0.00%	6.72

*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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