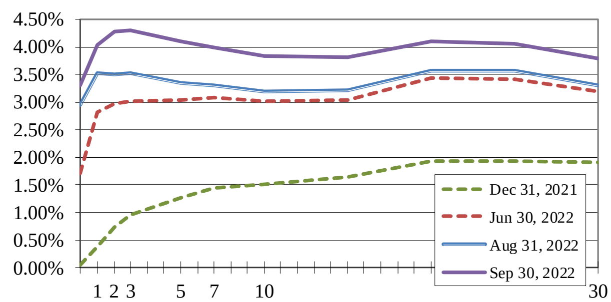
Baird Advisors
Fixed Income Market Commentary
September 2022

Treasury Yields Reach New 2022 Highs in September Capping a Difficult Quarter for Bonds

For the third consecutive meeting, the Fed hiked its policy rate by 75 bps and reiterated its resolve to fight inflation until the "job is done", even at the risk of causing below trend growth. Median FOMC Fed Funds projections for 2022-year end rose sharply from 3.38% after the June meeting to 4.38% following the September meeting. The 10yr Treasury yield set a new YTD closing high at 3.95% on September 27th before falling to 3.84%, up 64 bps for the month and 82 bps for the quarter. Treasury yields rose somewhat uniformly across the curve in September, while quarterly increases were largest among short maturities, including a 132 bps increase in the 2yr yield. Headline CPI inflation fell to 8.3%, its second consecutive decline from the 9.06% June peak, but still well above Fed's 2% target, justifying their hawkish stance. Strong payroll data (+315k jobs) remained a challenge to the Fed's inflation fight, but other impacts of a restrictive Fed are emerging. 30yr Mortgage Rates have climbed to 6.70%, impacting affordability. Overseas bond market volatility was also evident as other central banks fight inflation. UK 5yr sovereign debt (Gilts) yields, which were 248 bps higher in the quarter, rose over 100 bps in just three days after the release of surprise fiscal stimulus plans. The Bank of England, aiming to calm investors and support prices, announced a temporary Gilt purchasing program while also delaying the start of their planned balance sheet reduction in October.



Treasury Yields

Maturity	12/31/21	6/30/22	8/31/22	9/30/22	1Mo Chg	Q3 Chg	YTD Chg
3 Mo	0.06%	1.71%	2.95%	3.29%	0.34%	1.58%	3.23%
1	0.39%	2.81%	3.53%	4.05%	0.52%	1.24%	3.66%
2	0.74%	2.96%	3.50%	4.28%	0.78%	1.32%	3.54%
3	0.96%	3.01%	3.52%	4.29%	0.77%	1.28%	3.33%
5	1.27%	3.04%	3.35%	4.09%	0.74%	1.05%	2.82%
7	1.44%	3.08%	3.31%	3.99%	0.68%	0.91%	2.55%
10	1.51%	3.02%	3.20%	3.84%	0.64%	0.82%	2.33%
20	1.94%	3.44%	3.57%	4.09%	0.52%	0.65%	2.15%
30	1.91%	3.19%	3.30%	3.78%	0.48%	0.59%	1.87%

Corporate Spreads Wider on Heightened Volatility

IG Corporate spreads rose in September to a YTD wide of +164 bps on fears of a slowing economy, finishing the month at +159 bps. Agency RMBS volatility exceeded historical norms and spreads widened for the month (+29) and quarter (+23) in part due to reduced demand from the Fed and banks. High Yield widened in September (+68) in sympathy with equity price declines but finished Q3 tighter (-17).

Agency RMBS Notably Underperform

Agency RMBS returns were the lowest among US sectors for September and Q3. The Agency RMBS index experienced return extremes, providing its best all-time excess return in July (+1.29%) only to be followed in September by its worst monthly excess return (-1.91%) since data inception in 1988. ABS was the lone sector to produce positive monthly excess returns (+0.13). IG corporate excess returns were negative for the month (-1.42%) and quarter (-0.33%). Emerging Market Debt, impacted by dollar strength, declined 5.87% in September.

Option-Adjusted Spreads (in bps)

	12/31/21	6/30/22	8/31/22	9/30/22	1Mo Chg	Q3 Chg	YTD Chg
U.S. Aggregate Index	36	55	50	62	12	7	26
U.S. Agency (non-mortgage)	8	17	19	15	-4	-2	7
Mortgage and ABS Sectors							
U.S. Agency RMBS (Pass-throughs)	31	46	40	69	29	23	38
U.S. Agency CMBS	34	41	50	48	-2	7	14
U.S. Non-Agency CMBS	95	152	147	154	7	2	59
Asset-Backed Securities	38	75	62	53	-9	-22	15
Corporate Sectors							
U.S. Investment Grade	92	155	140	159	19	4	67
Industrial	95	153	138	155	17	2	60
Utility	107	156	141	158	17	2	51
Financial Institutions	83	159	144	166	22	7	83
Non-Corporate Credit	55	72	69	73	4	1	18
U.S. High Yield Corporates	283	569	484	552	68	-17	269
Emerging Market Debt	581	835	757	824	67	-11	243

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	-4.32%	-0.91%	-4.75%	-0.57%	-14.61%	-1.86%	6.20
U.S. Gov't/Credit Index	-4.08%	-0.54%	-4.56%	-0.14%	-15.10%	-1.40%	6.36
U.S. Intermediate Gov't/Credit Index	-2.67%	-0.27%	-3.06%	0.01%	-9.62%	-0.74%	3.86
U.S. 1-3 Yr. Gov't/Credit Index	-1.22%	-0.08%	-1.48%	0.02%	-4.54%	-0.17%	1.89
U.S. Treasury	-3.45%	0.00%	-4.35%	0.00%	-13.09%	0.00%	6.10
U.S. Agency (Non-Mortgage)	-2.10%	-0.12%	-2.69%	-0.21%	-8.51%	-0.72%	3.44
U.S. Agency RMBS (Pass-Throughs)	-5.05%	-1.91%	-5.35%	-1.69%	-13.66%	-3.11%	5.94
CMBS (Commercial Mortgage-Backed Sec.)	-3.11%	-0.25%	-3.85%	-0.26%	-11.81%	-1.10%	4.70
ABS (Asset-Backed Securities)	-1.16%	0.13%	-1.34%	0.30%	-5.06%	-0.11%	2.16
U.S. Corporate Investment Grade	-5.26%	-1.42%	-5.06%	-0.33%	-18.72%	-3.57%	7.09
U.S. High Yield Corporates	-3.97%	-1.53%	-0.65%	2.27%	-14.74%	-6.24%	4.11
Emerging Market Debt	-5.87%	-2.84%	-3.46%	0.40%	-20.48%	-9.42%	4.84
Municipal Bond Index	-3.84%	N/A	-3.46%	N/A	-12.13%	N/A	7.15
TIPS (Treasury Inflation Protected Sec.)	-6.62%	0.00%	-5.14%	0.00%	-13.61%	0.00%	6.80

*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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