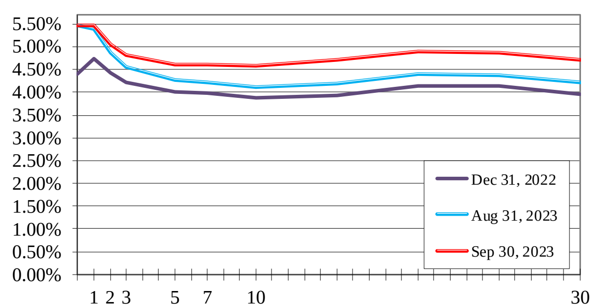
Baird Advisors
Fixed Income Market Commentary
September 2023

Yields Rise Sharply as Fed Reinforces Higher for Longer Messaging on Stronger Than Expected Growth and Sticky Inflation
Treasury yields climbed steadily for the month and quarter as the 10yr rose 46 bps in September and 73 bps in Q3. The curve became notably less inverted as the term premium for longer maturities grew, meaning investors demanded additional income to extend duration. Treasury 2s/10s slope hit its cycle low of -108 bps in early July and ended September at -48 bps on prospects that the Fed may need to stay restrictive longer than previously expected. While the Fed left its policy rate unchanged at 5.50% in September, it reiterated its commitment to bringing inflation back to 2%. The Fed's Summary of Economic Projections (SEP) underscored these views as rate cut expectations by year end 2024 fell to 50 bps from 100 bps in June's SEP. The Fed also acknowledged the stronger than expected growth this year as Real GDP forecasts were revised upward to 2.1% for 2023 from 1.0% in the June SEP. Job creation (+187k August) remained robust and jobless claims came in below estimates all four weeks in September, complicating the Fed's effort to cool the economy. A mid-month UAW strike against the big-3 U.S. carmakers won't influence jobs data until subsequent releases. Oil prices rose nearly 30% in the quarter as Saudi Arabia and Russia extended cuts in output. Higher energy costs contributed to an increase in headline CPI inflation (3.7% YoY), above both the prior reading (3.2%) and estimates (3.6%). House Speaker McCarthy negotiated a short-term spending deal in the waning moments of the month to fund the government and avert a shutdown. Congress now has until mid-November to address spending cuts, border security, and funding for Ukraine's war against Russia.

Treasury Yields



Maturity	12/31/22	6/30/23	8/31/23	9/30/23	1 Mo Chg	Q3 Chg	YTD Chg
3 Mo	4.41%	5.31%	5.47%	5.46%	-0.01%	0.15%	1.05%
1	4.73%	5.44%	5.40%	5.48%	0.08%	0.04%	0.75%
2	4.43%	4.90%	4.87%	5.05%	0.18%	0.15%	0.62%
3	4.23%	4.53%	4.56%	4.81%	0.25%	0.28%	0.58%
5	4.01%	4.16%	4.26%	4.61%	0.35%	0.45%	0.60%
7	3.97%	4.01%	4.21%	4.62%	0.41%	0.61%	0.65%
10	3.88%	3.84%	4.11%	4.57%	0.46%	0.73%	0.69%
20	4.15%	4.08%	4.41%	4.90%	0.49%	0.82%	0.75%
30	3.97%	3.86%	4.22%	4.70%	0.48%	0.84%	0.73%

Spreads Steady for Month and Quarter
IG Corporate spreads widened just +3 bps in September and finished Q3 -2 tighter. ABS spreads were stable for the month and quarter. Non-Agy CMBS tightened -8 bps in the quarter. Agy RMBS was an exception and widened +14 bps in Q3 with +13 bps occurring in September. US HY Corporates widened +22 bps for the month and +4 bps for the quarter.

Large September Declines Cap Difficult 3Q for Agg Index
The US Agg Index declined -2.54% in September and -3.23% for the quarter bringing YTD returns to -1.21%. Agy RMBS notably underperformed on reduced demand and higher rate volatility. Its excess returns of -0.81% and -0.85% for the month and quarter were lowest among major sectors. IG Corporate excess returns were strong for the quarter (+0.84%). Taxable municipals offered strong excess returns for the month (+0.49%) and quarter (+1.45%).

Option-Adjusted Spreads (in bps)

	12/31/22	6/30/23	8/31/23	9/30/23	1Mo Chg	Q3 Chg	YTD Chg
U.S. Aggregate Index	51	49	48	52	4	3	1
U.S. Agency (non-mortgage)	26	19	19	16	-3	-3	-10
Mortgage and ABS Sectors							
U.S. Agency RMBS (Pass-throughs)	51	52	53	66	13	14	15
U.S. Agency CMBS	52	51	58	54	-4	3	2
U.S. Non-Agency CMBS	179	211	202	203	1	-8	24
Asset-Backed Securities	76	68	63	67	4	-1	-9
Corporate Sectors							
U.S. Investment Grade	130	123	118	121	3	-2	-9
Industrial	125	113	108	110	2	-3	-15
Utility	129	132	124	122	-2	-10	-7
Financial Institutions	140	139	132	140	8	1	0
Non-Corporate Credit	66	58	54	56	2	-2	-10
U.S. High Yield Corporates	469	390	372	394	22	4	-75
Emerging Market Debt	687	681	649	648	-1	-33	-39

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total Return	MTD Excess Return	Q3 Total Return	Q3 Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	-2.54%	-0.21%	-3.23%	0.00%	-1.21%	0.50%	6.15
U.S. Gov't/Credit Index	-2.34%	0.01%	-3.00%	0.32%	-0.85%	0.92%	6.12
U.S. Intermediate Gov't/Credit Index	-1.08%	-0.08%	-0.83%	0.04%	0.65%	0.44%	3.76
U.S. 1-3 Yr. Gov't/Credit Index	-0.05%	-0.03%	0.73%	0.00%	1.87%	0.10%	1.85
U.S. Treasury	-2.21%	0.00%	-3.06%	0.00%	-1.52%	0.00%	5.86
U.S. Agency (Non-Mortgage)	-0.62%	0.05%	-0.24%	0.17%	1.40%	0.48%	3.14
U.S. Agency RMBS (Pass-Throughs)	-3.19%	-0.81%	-4.05%	-0.85%	-2.26%	-0.58%	6.42
CMBS (Commercial Mortgage-Backed Securities)	-1.19%	0.12%	-1.02%	0.35%	0.16%	0.45%	4.38
ABS (Asset-Backed Securities)	-0.43%	0.01%	0.25%	0.29%	1.99%	0.84%	2.65
U.S. Corporate Investment Grade	-2.67%	0.05%	-3.09%	0.84%	0.02%	2.37%	6.76
U.S. High Yield Corporates	-1.18%	-0.37%	0.46%	1.02%	5.86%	5.16%	3.52
Emerging Market Debt	-1.86%	-0.17%	-0.60%	1.48%	3.09%	3.88%	4.86
Municipal Bond Index	-2.93%	N/A	-3.95%	N/A	-1.38%	N/A	6.37
Taxable Municipal Bond: Agg Eligible	-3.64%	0.49%	-4.90%	1.45%	-0.12%	4.27%	9.27
TIPS (Treasury Inflation Protected Securities)	-1.85%	0.00%	-2.60%	0.00%	-0.78%	0.00%	6.48

*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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