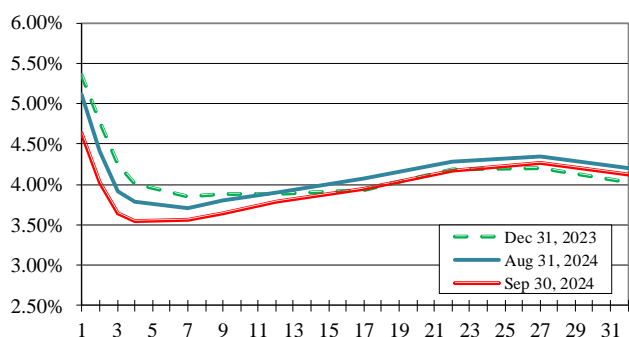


Baird Advisors Fixed Income Market Commentary September 2024

Fed Cuts 50 bps, Positive 2s10s Curve Slope Returns as Short Rates Fall the Most

The 10yr yield fell 13 bps for the month and 62 bps for the quarter, finishing September at 3.78%, 10 bps below where it began 2024. That move was outpaced by the 2yr, which fell 28 bps in September and 112 bps in Q3. The steepening of the Treasury curve led to a positive slope in the 2s10s segment of +14 bps at quarter end, its first upward posture in 26 months, 51 bps steeper YTD. While the Fed had clearly signaled the onset of easing, market expectations were split between a 25 and 50 bps rate cut prior to the September FOMC meeting. Ultimately, the Fed opted for a 50 bps rate cut, to a 4.75% - 5.00% range, with one dissenting vote who preferred 25 bps. The PCE Price Index, the Fed's preferred inflation measure, validated the decision as it fell in August to 2.2% YoY from 2.5% the prior month and below the 2.3% consensus estimate. The larger rate cut was also guided by the Fed's aim "supporting maximum employment," a newly added phrase to the Fed statement, alongside its 2% inflation target. The August nonfarm payroll report featured +142k jobs, below the +165k market estimate even as data from prior months was revised lower. Finally, in late-September, Fed Chair Powell advised that the Fed was "not on any preset course" of easing. Market consensus, nevertheless, had priced in nearly 75 bps of cuts before year end and roughly 125 bps of easing next year, both more aggressive than the Fed's own estimates of policy change.

Treasury Yields



Maturity	12/31/23	6/30/24	8/31/24	9/30/24	1 Mo Chg	Q3 Chg	YTD Chg
3 Mo	5.36%	5.36%	5.12%	4.64%	-0.48%	-0.72%	-0.72%
1	4.78%	5.13%	4.41%	4.02%	-0.39%	-1.11%	-0.76%
2	4.25%	4.76%	3.92%	3.64%	-0.28%	-1.12%	-0.61%
3	4.01%	4.55%	3.78%	3.55%	-0.23%	-1.00%	-0.46%
5	3.85%	4.38%	3.70%	3.56%	-0.14%	-0.82%	-0.29%
7	3.88%	4.38%	3.80%	3.65%	-0.15%	-0.73%	-0.23%
10	3.88%	4.40%	3.91%	3.78%	-0.13%	-0.62%	-0.10%
20	4.20%	4.66%	4.29%	4.18%	-0.11%	-0.48%	-0.02%
30	4.03%	4.56%	4.20%	4.12%	-0.08%	-0.44%	0.09%

Spreads Tighter on Economic Soft-Landing Prospects

IG Corporate spreads tightened despite outsized new issuance, including a record week to begin September. Prospects of the Fed engineering a soft landing paired with income-focused buyers aiming to lock in absolute yields in advance of future Fed cuts enabled spreads to tighten -4 bps in September and -5 bps for Q3. Agency RMBS finished +3 bps wider for the month but -6 bps tighter for the quarter.

Outsized Rally Across the Bond Market in Q3

The Agg Index returned 1.34% in the month and 5.20% for Q3, its second largest quarterly return over the past 25 years. Among IG sector excess returns, Agency RMBS (+0.78%) and IG Corporates (+0.77%) led in Q3. US HY and EM Debt led all sectors in excess return for the month and quarter. Taxable Munis underperformed in Q3 after strong performance 1H '24.

Option-Adjusted Spreads (in bps)

	12/31/23	6/30/24	8/31/24	9/30/24	1 Mo Chg	Q3 Chg	YTD Chg
U.S. Aggregate Index	42	39	36	36	0	-3	-6
U.S. Agency (non-mortgage)	17	13	16	16	0	3	-1
Mortgage and ABS Sectors							
U.S. Agency RMBS (Pass-throughs)	47	48	39	42	3	-6	-5
U.S. Agency CMBS	48	40	40	39	-1	-1	-9
U.S. Non-Agency CMBS	203	154	156	149	-7	-5	-54
Asset-Backed Securities	68	57	64	64	0	7	-4
Corporate Sectors							
U.S. Investment Grade	99	94	93	89	-4	-5	-10
Industrial	90	90	90	87	-3	-3	-3
Utility	105	104	101	92	-9	-12	-13
Financial Institutions	112	97	95	90	-5	-7	-22
Non-Corporate Credit	55	53	53	54	1	1	-1
U.S. High Yield Corporates	323	309	305	295	-10	-14	-28
Emerging Market Debt	598	513	513	470	-43	-43	-128

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	1.34%	0.12%	5.20%	0.40%	4.45%	0.61%	6.20
U.S. Gov't/Credit Index	1.40%	0.16%	5.10%	0.27%	4.39%	0.61%	6.43
U.S. Intermediate Gov't/Credit Index	1.08%	0.08%	4.17%	0.16%	4.68%	0.48%	3.80
U.S. 1-3 Yr. Gov't/Credit Index	0.83%	0.02%	2.96%	0.08%	4.38%	0.20%	1.85
U.S. Treasury	1.20%	0.00%	4.74%	0.00%	3.84%	0.00%	6.11
U.S. Agency (Non-Mortgage)	0.95%	0.04%	3.40%	0.05%	4.27%	0.29%	3.23
U.S. Agency RMBS (Pass-Throughs)	1.19%	-0.02%	5.53%	0.78%	4.50%	0.52%	5.71
CMBS (Commercial Mortgage Backed Securities)	1.30%	0.23%	4.65%	0.36%	6.25%	2.15%	4.23
ABS (Asset-Backed Securities)	0.98%	0.08%	3.35%	0.15%	5.07%	0.89%	2.77
U.S. Corporate Investment Grade	1.77%	0.48%	5.84%	0.77%	5.32%	1.65%	7.17
U.S. High Yield Corporates	1.62%	0.70%	5.28%	1.72%	8.00%	3.80%	2.93
Emerging Market Debt	2.45%	1.36%	6.53%	2.30%	12.85%	8.93%	4.92
Municipal Bond Index	0.99%	N/A	2.71%	N/A	2.30%	N/A	6.12
Taxable Municipal Bond: Agg Eligible	1.61%	0.08%	5.96%	-0.04%	4.68%	1.34%	9.55
TIPS (Treasury Inflation Protected Securities)	1.50%	0.00%	4.12%	0.00%	4.85%	0.00%	6.84

*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.