

Baird Advisors

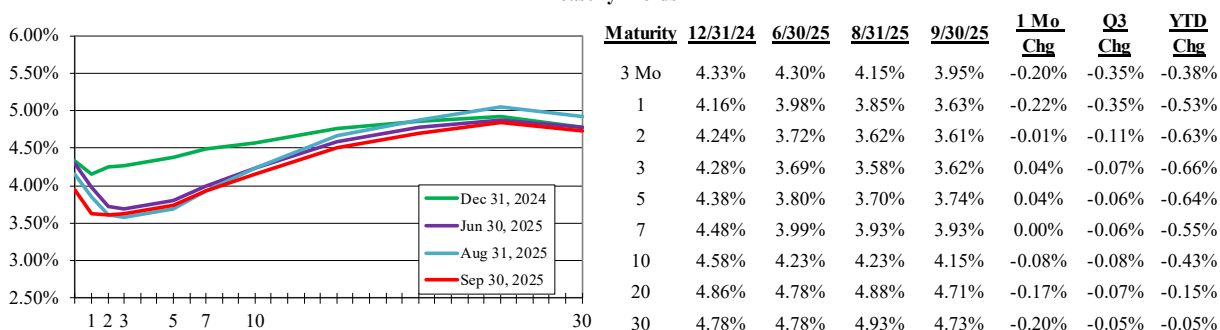
Fixed Income Market Commentary

September 2025

Treasury Yields Decline in Q3 as Fed Cuts Rates Amid Revised Slower Labor Data

The 10yr Treasury yield declined 8 bps for the quarter to finish at 4.15% while the 2yr maturity declined 11 bps, leaving the 2s10s slope 3 bps steeper in Q3. Weaker labor data, including August nonfarm payrolls of just 22k vs 75k estimates accompanied by large revisions lower to prior months data fueled the decline in Treasury yields. For example, the Bureau of Labor Statistics indicated -911k fewer jobs were created in the twelve months ending March 2025 than previously reported, the largest annual revision in history. The Fed subsequently lowered the fed funds rate by 25 bps in September to 4.00-4.25%. Noting that the “downside risks to employment have risen,” Chair Powell dubbed it a “risk management” rate cut, with one dissenter preferring a 50 bp cut. Further reflecting the divided Fed was the updated “dot plot” in which seven FOMC members expect no further cuts this year with ten others anticipating at least two additional cuts. The Fed’s own Summary of Economic Projections (SEP) for 2026 revised up the median outlook for growth (to 1.8% from 1.6%), the unemployment rate down (to 4.4% from 4.5%) and inflation higher (to 2.6% from 2.4%). On the policy front, tariff negotiations continue with new tariffs assessed on pharmaceuticals. As September concluded, the Federal government was poised to shut down as a stopgap funding bill failed in the Senate, primarily on disagreements over ACA premiums and Medicaid spending.

Treasury Yields



Spread Tightening Continues in Q3

Spread tightening from Q2 continued through Q3. All major sectors finished the quarter tighter, led by US High Yield (-23 bps). IG Corporate spreads tightened in September despite elevated issuance given persistent demand for income by investors, particularly in long maturities. In IG Corporates, YTD tight spreads of +72 occurred in September, the sector’s tightest reading since 1998, before it closed the month at +74.

Strong Total and Excess Returns in September and Q3

The Agg Index produced 1.09% of total return for the month, bringing the quarterly return to 2.03%. Excess returns for the quarter were noteworthy in Agg RMBS (+0.83%) given their high quality, nearly matching IG Corporate (+0.98%). Municipals rebounded in September, reversing some earlier 2025 underperformance.

Option-Adjusted Spreads (in bps)

	12/31/24	6/30/25	8/31/25	9/30/25	1 Mo Chg	Q3 Chg	YTD Chg
U.S. Aggregate Index*	32	32	30	28	-2	-4	-4
U.S. Agency (non-mortgage)	12	10	11	10	-1	0	-2
Mortgage and ABS Sectors							
U.S. Agency RMBS (Pass-throughs)*	34	37	34	31	-3	-6	-3
U.S. Agency CMBS	35	37	35	31	-4	-6	-4
U.S. Non-Agency CMBS	127	132	122	121	-1	-11	-6
Asset-Backed Securities	44	57	51	49	-2	-8	5
Corporate Sectors							
U.S. Investment Grade	80	83	79	74	-5	-9	-6
Industrial	78	81	77	72	-5	-9	-6
Utility	82	93	86	81	-5	-12	-1
Financial Institutions	82	85	80	74	-6	-11	-8
Non-Corporate Credit	55	51	45	43	-2	-8	-12
U.S. High Yield Corporates	287	290	272	267	-5	-23	-20
Emerging Market Debt	393	393	363	380	17	-13	-13

Source: Bloomberg Indices
 *U.S. Aggregate Index and U.S. Agency RMBS spreads in 2024 have been adjusted to incorporate Bloomberg’s most recent prepayment model, which was updated on 1/24/2025.
 (Bloomberg updates the prepayment model on an annual basis which impacts the sector OAS).

Total Returns of Selected Bloomberg Indices and Subsectors

	MTD Total	MTD Excess	3 Mo Total	3 Mo Excess	YTD Total	YTD Excess	Effective Duration (years)
U.S. Aggregate Index	1.09%	0.21%	2.03%	0.48%	6.13%	0.60%	6.04
U.S. Gov’t/Credit Index	1.07%	0.17%	1.91%	0.36%	5.93%	0.47%	6.20
U.S. Intermediate Gov’t/Credit Index	0.42%	0.11%	1.51%	0.23%	5.70%	0.39%	3.76
U.S. 1-3 Yr. Gov’t/Credit Index	0.33%	0.02%	1.19%	0.06%	4.14%	0.18%	1.87
U.S. Treasury	0.85%	0.00%	1.51%	0.00%	5.36%	0.00%	5.90
U.S. Agency (Non-Mortgage)	0.49%	0.02%	1.39%	0.09%	4.88%	0.22%	3.30
U.S. Agency RMBS (Pass-Throughs)	1.22%	0.35%	2.43%	0.83%	6.76%	0.97%	5.76
CMBS (Commercial Mortgage Backed Securities)	0.40%	0.10%	1.75%	0.48%	6.32%	0.84%	3.88
ABS (Asset-Backed Securities)	0.55%	0.11%	1.64%	0.39%	4.62%	0.38%	2.77
U.S. Corporate Investment Grade	1.50%	0.48%	2.60%	0.98%	6.88%	1.23%	6.90
U.S. High Yield Corporates	0.82%	0.48%	2.54%	1.29%	7.22%	2.40%	2.85
Emerging Market Debt	0.32%	-0.31%	3.03%	1.60%	8.52%	3.12%	4.93
Municipal Bond Index	2.32%	N/A	3.00%	N/A	2.64%	N/A	6.86
Taxable Municipal Bond: Agg Eligible	1.66%	0.18%	2.75%	0.86%	6.42%	0.22%	9.15
TIPS (Treasury Inflation Protected Securities)	0.43%	0.00%	2.10%	0.00%	6.87%	0.00%	6.61

*Excess return represents the return of a spread sector versus a like-duration U.S. Treasury.

Disclosures

Information in this document regarding market or economic trends, or the factors influencing historical or future performance, reflects the opinions of management as of the date of this document. These statements should not be relied upon for any other purpose. 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. *Past performance is not a guarantee of future results.*

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.

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.

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. Indices are unmanaged and are not available for direct investment.