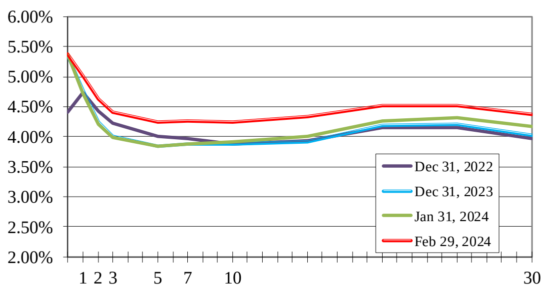
Baird Advisors
Fixed Income Market Commentary
February 2024

Strong Economic Data and Reduced Fed Rate Cut Expectations Lift Treasury Yields

Treasury yields rose in February with a slight flattening bias; two-year rates rose 41 bps, 10yr yields were up 34 bps (deepening the 2s10s inversion to -37 bps at month end) and 30yr rates rose 21 bps. The higher yields in both January and February, partially reversing the strong rate rally into year end, have been supported by persistently strong economic data and higher than expected inflation. For example, labor market strength continued as January payrolls reported 353k new jobs (+185k estimate) and the unemployment rate held steady at 3.7% for three consecutive months. Inflation, as measured by both the CPI and Core CPI, came in above expectations, at 3.1% and 3.9% YoY, respectively. Fed Chair Powell noted in a "60 Minutes" interview that given the economic strength "we can approach the question of when to begin to reduce rates carefully," indicating that the Fed wants to "gain a little more confidence that (inflation) is coming down in a sustainable way." By month end, market expectations for total Fed rate cuts this year had declined to just three from six at the start of the year, with the first move now expected in June rather than March or May. Finally, Congress passed another stopgap spending bill to avoid a partial government shutdown at month end.

Treasury Yields



Maturity	12/31/22	12/31/23	1/31/24	2/29/24	1 Mo Chg	YTD Chg
3 Mo	4.41%	5.36%	5.38%	5.39%	0.01%	0.03%
1	4.73%	4.78%	4.72%	5.01%	0.29%	0.23%
2	4.43%	4.25%	4.21%	4.62%	0.41%	0.37%
3	4.23%	4.01%	3.99%	4.42%	0.43%	0.41%
5	4.01%	3.85%	3.84%	4.25%	0.41%	0.40%
7	3.97%	3.88%	3.88%	4.27%	0.39%	0.39%
10	3.88%	3.88%	3.91%	4.25%	0.34%	0.37%
20	4.15%	4.20%	4.27%	4.52%	0.25%	0.32%
30	3.97%	4.03%	4.17%	4.38%	0.21%	0.35%

Non-Agency CMBS Tightening Continues in February

Non-Agency CMBS tightened -16 bps in February, led by the lowest rated segments (BBB rated CMBS -67 bps tighter), bringing the YTD change to -43 bps. IG corporate spreads were unchanged as tightening to begin the month was offset by a reversal in the final week on record February issuance. Financials were the sole corporate subsector tighter on the month (-4 bps) and ended -9 bps tighter YTD. US High Yield and EM debt both moved notably tighter in February, more than offsetting their January widening.

Negative February Returns Add to YTD Declines

The Agg Index followed its January decline by falling -1.41% in February bringing YTD returns to -1.68% as Treasury yields rose. While nominal returns were negative across taxable IG subsectors, positive excess returns were produced in CMBS (+0.44%), ABS (+0.22%) and Taxable Munis (+0.39%). Agy RMBS had the lowest excess returns in February (-0.29%). Excess returns were only modestly negative in IG Corporates during February (-0.11%) but remain positive YTD (+0.33%).

Option-Adjusted Spreads (in bps)

	12/31/22	12/31/23	1/31/24	2/29/24	1Mo Chg	YTD Chg
U.S. Aggregate Index	51	42	40	41	1	-1
U.S. Agency (non-mortgage)	26	17	14	12	-2	-5
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)	51	47	47	51	4	4
U.S. Agency CMBS	52	48	49	44	-5	-4
U.S. Non-Agency CMBS	179	203	176	160	-16	-43
Asset-Backed Securities	76	68	62	55	-7	-13
Corporate Sectors						
U.S. Investment Grade	130	99	96	96	0	-3
Industrial	125	90	89	91	2	1
Utility	129	105	101	102	1	-3
Financial Institutions	140	112	107	103	-4	-9
Non-Corporate Credit	66	55	54	52	-2	-3
U.S. High Yield Corporates	469	323	344	312	-32	-11
Emerging Market Debt	687	598	609	556	-53	-42

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	Feb Total Return	Feb Excess Return	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	-1.41%	-0.09%	-1.68%	-0.01%	6.22
U.S. Gov't/Credit Index	-1.36%	-0.03%	-1.59%	0.13%	6.30
U.S. Intermediate Gov't/Credit Index	-0.99%	0.06%	-0.79%	0.09%	3.77
U.S. 1-3 Yr. Gov't/Credit Index	-0.36%	0.02%	0.02%	0.05%	1.84
U.S. Treasury	-1.31%	0.00%	-1.59%	0.00%	6.04
U.S. Agency (Non-Mortgage)	-0.66%	0.02%	-0.38%	0.15%	3.19
U.S. Agency RMBS (Pass-Throughs)	-1.63%	-0.29%	-2.08%	-0.47%	6.19
CMBS (Commercial Mortgage Backed Securities)	-0.77%	0.44%	-0.06%	1.08%	4.33
ABS (Asset-Backed Securities)	-0.28%	0.22%	0.18%	0.47%	2.63
U.S. Corporate Investment Grade	-1.50%	-0.11%	-1.67%	0.33%	6.93
U.S. High Yield Corporates	0.29%	1.09%	0.29%	0.87%	3.21
Emerging Market Debt	2.09%	3.19%	1.87%	3.10%	4.93
Municipal Bond Index	0.13%	N/A	-0.38%	N/A	6.09
Taxable Municipal Bond: Agg Eligible	-1.42%	0.39%	-1.62%	1.26%	9.33
TIPS (Treasury Inflation Protected Securities)	-1.07%	0.00%	-0.90%	0.00%	6.77

*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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