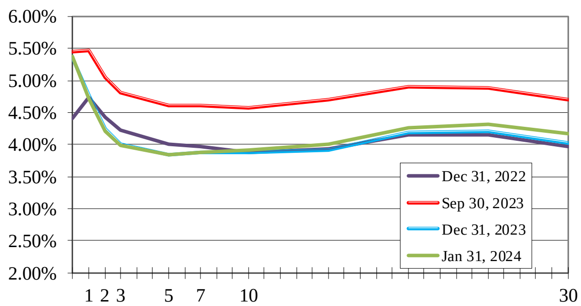
Baird Advisors
Fixed Income Market Commentary
January 2024

Rangebound Treasury Yields with a Steepening Bias, Inflation Cooling Alongside Resilient US Economy

Following the sharp rally in November and December, Treasuries were rangebound in January but with a steepening bias as short rates fell while long rates rose. The 10yr started 2024 at 3.88% and rose to 4.18% before ending the month at 3.91%, just 3 bps higher at month-end. Resilient economic growth (GDP Q4 +3.3% vs +2% est.), strong consumer spending (+0.7% vs +0.5% est.) and better than expected payrolls (+216k vs +175k est.) put modest upward pressure on yields. Yet, Core PCE, the Fed's preferred inflation measure, slipped to 2.9% YoY in December from 3.2% the prior month; the 6-month annualized rate is now just 1.9%. In the press conference following January's FOMC meeting, Fed Chair Jay Powell confirmed that rate cuts are likely if favorable inflation data continues but he lowered market expectations for March easing as likely too soon to begin cutting rates. One support to Treasury prices was a surprise from the US Treasury which lowered its Q1 refunding estimate to $760B, down from $816B, on higher tax revenue forecasts. In Washington, the House advanced an economically stimulative bipartisan $78bn tax-cut proposal, which provides corporate tax savings as well as an expanded individual child tax credit.

Treasury Yields



Maturity	12/31/22	9/30/23	12/31/23	1/31/24	1 Mo Chg
3 Mo	4.41%	5.46%	5.36%	5.38%	0.02%
1	4.73%	5.48%	4.78%	4.72%	-0.06%
2	4.43%	5.05%	4.25%	4.21%	-0.04%
3	4.23%	4.81%	4.01%	3.99%	-0.02%
5	4.01%	4.61%	3.85%	3.84%	-0.01%
7	3.97%	4.62%	3.88%	3.88%	0.00%
10	3.88%	4.57%	3.88%	3.91%	0.03%
20	4.15%	4.90%	4.20%	4.27%	0.07%
30	3.97%	4.70%	4.03%	4.17%	0.14%

Non-Agy CMBS Tightens Notably in January

Non-Agy CMBS tightened -27 bps in January to finish the month at +176 bps. The move was a delayed response to tightening in other sectors and a reflection of higher average spreads to begin the month (+203 bps). Agency RMBS spreads were unchanged in January. IG Corporate tightened -3 bps in January, led by Financials (-5 bps). HY Corporate and EM Debt spreads both widened for the month.

Modestly Negative Returns in January Follow Strong Q4 Rally

The Agg Index declined -0.27% in January. CMBS provided the highest nominal returns (+0.72%) and strong excess returns of +0.64%. Agency RMBS declined -0.46% (-0.18% excess returns) following a sharp year-end rally. Municipals, another outperforming sector from Q4, declined most among IG sectors (-0.51%). IG Corporates provided +0.44% excess returns despite record January issuance of roughly $200bn. Tighter spreads and flatter than normal credit curves persist as investors focus on the attractive overall yields still offered in the bond market.

Option-Adjusted Spreads (in bps)

	12/31/22	9/30/23	12/31/23	1/31/24	1Mo Chg
U.S. Aggregate Index	51	52	42	40	-2
U.S. Agency (non-mortgage)	26	16	17	14	-3
Mortgage and ABS Sectors					
U.S. Agency RMBS (Pass-throughs)	51	66	47	47	0
U.S. Agency CMBS	52	54	48	49	1
U.S. Non-Agency CMBS	179	203	203	176	-27
Asset-Backed Securities	76	67	68	62	-6
Corporate Sectors					
U.S. Investment Grade	130	121	99	96	-3
Industrial	125	110	90	89	-1
Utility	129	122	105	101	-4
Financial Institutions	140	140	112	107	-5
Non-Corporate Credit	66	56	55	54	-1
U.S. High Yield Corporates	469	394	323	344	21
Emerging Market Debt	687	648	598	609	11

Source: Bloomberg Indices

Total Returns of Selected Bloomberg Indices and Subsectors

	2023 Total Return	MTD Total Return	MTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	5.53%	-0.27%	0.08%	6.25
U.S. Gov't/Credit Index	5.72%	-0.23%	0.16%	6.37
U.S. Intermediate Gov't/Credit Index	5.24%	0.21%	0.03%	3.77
U.S. 1-3 Yr. Gov't/Credit Index	4.61%	0.39%	0.02%	1.83
U.S. Treasury	4.05%	-0.28%	0.00%	6.10
U.S. Agency (Non-Mortgage)	5.13%	0.29%	0.13%	3.20
U.S. Agency RMBS (Pass-Throughs)	5.05%	-0.46%	-0.18%	6.10
CMBS (Commercial Mortgage Backed Securities)	5.42%	0.72%	0.64%	4.39
ABS (Asset-Backed Securities)	5.54%	0.47%	0.25%	2.65
U.S. Corporate Investment Grade	8.52%	-0.17%	0.44%	7.03
U.S. High Yield Corporates	13.44%	0.00%	-0.22%	3.19
Emerging Market Debt	13.10%	-0.22%	-0.08%	4.92
Municipal Bond Index	6.40%	-0.51%	N/A	6.10
Taxable Municipal Bond: Agg Eligible	8.85%	-0.20%	0.88%	9.48
TIPS (Treasury Inflation Protected Securities)	3.90%	0.18%	0.00%	6.82

*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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