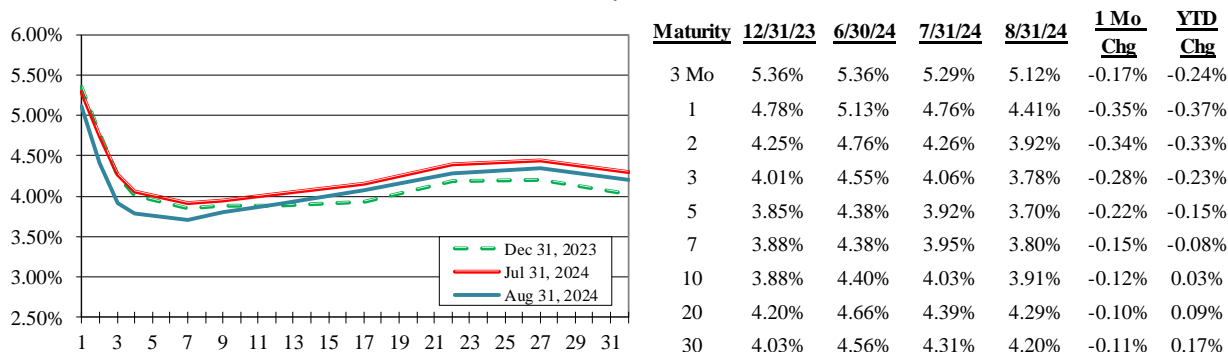


Baird Advisors Fixed Income Market Commentary August 2024

Fed Chair Powell Signals First Rate Cut in September, Helping to Normalize the Yield Curve

The 10yr Treasury yield fell 12 bps in August to 3.91%, just 3 bps above where it began the year and 80 bps below its YTD high (4.70%), while short-term rates fell even more. The 2yr yield fell 34 bps (-37 bps lower YTD), leaving the 2s10s yield curve inverted by just 1 bp, its least inverted position since July 2022. Economic data continued to exhibit a cooling trend. Nonfarm payrolls increased just 114k in July (175k consensus estimate) and prior months data were revised lower. Additionally, the Bureau of Labor Statistics released its preliminary annual benchmark revision showing 818k fewer jobs created (from April 2023 – March 2024) than previously reported, the largest revision since 2009. The unemployment rate also rose to 4.3% from 4.1%, up nearly a full percentage point from the 3.4% low in 2023. On the inflation front, the Fed’s preferred measure, PCE, held steady at 2.5% YoY, but other measures eased (CPI fell to 2.9% YoY from 3.0%); services prices continue to be sticky, but goods prices are softening, contributing to the moderating inflation data. Finally, Fed Chair Powell acknowledged at the annual Jackson Hole Economic Symposium that “the time has come for a policy adjustment”, and “the direction of travel is clear” for rates, but that the pace and destination will evolve with data.

Treasury Yields



Corporate Spreads Unchanged but Volatile Intra-Month

While IG Corporate spreads were unchanged for the month, they exhibited the highest intra-month volatility since last year. Spreads began at +93 bps and then climbed to +111 bps on softer economic data and contagion worries around an unwind of the Yen carry trade while Treasuries rallied before tightening back to +93 bps at month end. Agency RMBS tightened -5 bps in August. High Yield and EM Debt ended tighter despite outsized volatility early in August.

Option-Adjusted Spreads (in bps)

| | 12/31/23 | 6/30/24 | 7/31/24 | 8/31/24 | 1 Mo Chg | YTD Chg |
|----------------------------------|----------|---------|---------|---------|----------|---------|
| U.S. Aggregate Index | 42 | 39 | 38 | 36 | -2 | -6 |
| U.S. Agency (non-mortgage) | 17 | 13 | 14 | 16 | 2 | -1 |
| Mortgage and ABS Sectors | | | | | | |
| U.S. Agency RMBS (Pass-throughs) | 47 | 48 | 44 | 39 | -5 | -8 |
| U.S. Agency CMBS | 48 | 40 | 41 | 40 | -1 | -8 |
| U.S. Non-Agency CMBS | 203 | 154 | 155 | 156 | 1 | -47 |
| Asset-Backed Securities | 68 | 57 | 60 | 64 | 4 | -4 |
| Corporate Sectors | | | | | | |
| U.S. Investment Grade | 99 | 94 | 93 | 93 | 0 | -6 |
| Industrial | 90 | 90 | 90 | 90 | 0 | 0 |
| Utility | 105 | 104 | 102 | 101 | -1 | -4 |
| Financial Institutions | 112 | 97 | 97 | 95 | -2 | -17 |
| Non-Corporate Credit | 55 | 53 | 54 | 53 | -1 | -2 |
| U.S. High Yield Corporates | 323 | 309 | 314 | 305 | -9 | -18 |
| Emerging Market Debt | 598 | 513 | 524 | 513 | -11 | -85 |

Source: Bloomberg Indices

Bond Market Strength Continues in August

The Agg Index produced positive returns for the 4th consecutive month, up 1.44% in August, bringing YTD results to 3.07%. Excess returns were positive across the board in August aside from US Agency (non-mortgage) (-0.04%) and Taxable Muni (-0.19%). Agency RMBS delivered the largest monthly excess returns among IG sectors at +0.35%. IG Corporate excess returns were positive (+0.19%) despite a record 8th straight month of >\$100B issuance.

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 | 1.44% | 0.14% | 4.79% | 0.14% | 3.07% | 0.48% | 6.16 |
| U.S. Gov't/Credit Index | 1.38% | 0.07% | 4.56% | -0.11% | 2.95% | 0.44% | 6.37 |
| U.S. Intermediate Gov't/Credit Index | 1.15% | 0.05% | 3.87% | 0.01% | 3.55% | 0.40% | 3.79 |
| U.S. 1-3 Yr. Gov't/Credit Index | 0.91% | 0.01% | 2.68% | 0.03% | 3.51% | 0.17% | 1.85 |
| U.S. Treasury | 1.28% | 0.00% | 4.54% | 0.00% | 2.60% | 0.00% | 6.07 |
| U.S. Agency (Non-Mortgage) | 0.93% | -0.04% | 3.22% | 0.03% | 3.28% | -0.25% | 3.10 |
| U.S. Agency RMBS (Pass-Throughs) | 1.61% | 0.35% | 5.51% | 0.86% | 3.27% | 0.54% | 5.77 |
| CMBS (Commercial Mortgage Backed Securities) | 1.23% | 0.05% | 4.28% | 0.09% | 4.88% | 1.88% | 4.24 |
| ABS (Asset-Backed Securities) | 0.97% | 0.00% | 3.03% | 0.05% | 4.05% | 0.80% | 2.76 |
| U.S. Corporate Investment Grade | 1.57% | 0.19% | 4.66% | -0.32% | 3.49% | 1.15% | 7.08 |
| U.S. High Yield Corporates | 1.63% | 0.61% | 4.59% | 1.13% | 6.29% | 3.03% | 2.94 |
| Emerging Market Debt | 2.16% | 0.99% | 4.24% | 0.12% | 10.15% | 7.35% | 4.84 |
| Municipal Bond Index | 0.79% | N/A | 3.27% | N/A | 1.30% | N/A | 6.18 |
| Taxable Municipal Bond: Agg Eligible | 1.40% | -0.19% | 5.26% | -0.63% | 3.02% | 1.23% | 9.48 |
| TIPS (Treasury Inflation Protected Securities) | 0.78% | 0.00% | 3.39% | 0.00% | 3.30% | 0.00% | 6.84 |

*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.

RB2021-0805

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