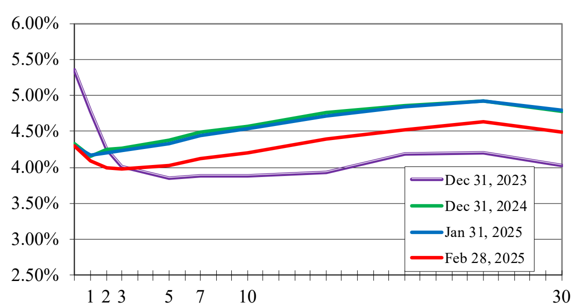
Baird Advisors
Fixed Income Market Commentary
February 2025

Treasury Yields Fall on Softer Economic Data and Policy Uncertainty

The 10yr Treasury yield declined to 4.21% in February, 33 bps lower on the month. The 2yr declined 21 bps, flattening the 2s10s curve segment by 12 bps and partially reversing the steepening trend in place since late last year. The U.S. economy showed signs of modest slowing as nonfarm payrolls rose 143k, less than the 175k expected. Consumer confidence, as measured by the Conference Board, also disappointed, falling to an 8-month low of 98.3, its biggest MoM decline since 2021, well below consensus expectations of 102.5. The Fed's preferred inflation measure, the PCE Price Index, slipped to 2.5% from 2.6% the prior month. While still above the Fed's 2% target, Fed Chair Powell acknowledged in testimony before Congress that the Fed does not "see any reason to be in a hurry to reduce it [the fed funds rate] further." Conversely, the Fed did signal that quantitative tightening (QT) may be coming to an end in the coming months. The flurry of news and announcements from the Trump administration added to investor uncertainty, yet the House was able to pass a budget bill that would extend President Trump's 2017 tax cuts by a slim majority of GOP votes. The plan would extend the tax cuts at a cost of $4.5T over 10 years, to be partially offset by expense reductions, which is the focus of the Department of Government Efficiency (DOGE).

Treasury Yields



Maturity	12/31/23	12/31/24	1/31/25	2/28/25	1 Mo Chg	YTD Chg
3 Mo	5.36%	4.33%	4.29%	4.31%	0.02%	-0.02%
1	4.78%	4.16%	4.17%	4.09%	-0.08%	-0.07%
2	4.25%	4.24%	4.20%	3.99%	-0.21%	-0.25%
3	4.01%	4.28%	4.24%	3.97%	-0.27%	-0.31%
5	3.85%	4.38%	4.33%	4.02%	-0.31%	-0.36%
7	3.88%	4.48%	4.44%	4.12%	-0.32%	-0.36%
10	3.88%	4.58%	4.54%	4.21%	-0.33%	-0.37%
20	4.20%	4.86%	4.84%	4.53%	-0.31%	-0.33%
30	4.03%	4.78%	4.79%	4.49%	-0.30%	-0.29%

Spreads Wider in February Aside from Agy RMBS

Spreads widened in February as Treasury yields declined and spread sector yields fell less on concern of a growth slowdown. Non-Agy CMBS and ABS each widened +3 bps. IG Corporate spreads finished +8 bps wider in February, led by longer maturities as demand potentially waned at lower yields. HY Corporates and EM Debt widened most (+19 and +26 bps, respectively). Agency RMBS was an exception during the month. It tightened by -3 bps.

Strong Absolute Returns in February

The Agg Index returned 2.20% in February. All subsectors produced positive total returns for the month but only Agy RMBS produced positive excess returns (+0.16%). CMBS excess returns for the month were negative (-0.05%). ABS excess returns finished at -0.04%. Among IG sectors, IG Corp excess returns were lowest (-0.55%) for the month, giving back some of the positive excess returns generated over the trailing year.

Option-Adjusted Spreads (in bps)

	12/31/23	12/31/24	1/31/25	2/28/25	1 Mo Chg	YTD Chg
U.S. Aggregate Index	42	34	30	32	2	-2
U.S. Agency (non-mortgage)	17	12	8	8	0	-4
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)*	47	43	34	31	-3	-3*
U.S. Agency CMBS	48	35	31	33	2	-2
U.S. Non-Agency CMBS	203	127	123	126	3	-1
Asset-Backed Securities	68	44	47	50	3	6
Corporate Sectors						
U.S. Investment Grade	99	80	79	87	8	7
Industrial	90	78	76	85	9	7
Utility	105	82	88	97	9	15
Financial Institutions	112	82	79	87	8	5
Non-Corporate Credit	55	55	52	56	4	1
U.S. High Yield Corporates	323	287	261	280	19	-7
Emerging Market Debt	598	393	373	399	26	6

Source: Bloomberg Indices
**Bloomberg updated U.S. Agency RMBS (Pass-Throughs) prepayment model effective 1/24/25. Adjusting to the new model, 12/31/24 OAS would be 34; 2025 spread changes reflect the adjusted 12/31/24 OAS.*

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	2.20%	-0.10%	1.06%	-0.10%	2.74%	-0.05%	6.10
U.S. Gov't/Credit Index	2.10%	-0.19%	0.94%	-0.15%	2.65%	-0.13%	6.24
U.S. Intermediate Gov't/Credit Index	1.39%	-0.07%	1.34%	-0.04%	1.97%	-0.01%	3.75
U.S. 1-3 Yr. Gov't/Credit Index	0.70%	0.00%	1.38%	0.01%	1.16%	0.04%	1.86
U.S. Treasury	2.16%	0.00%	1.10%	0.00%	2.68%	0.00%	5.96
U.S. Agency (Non-Mortgage)	1.27%	-0.01%	1.31%	0.03%	1.82%	0.12%	3.28
U.S. Agency RMBS (Pass-Throughs)	2.55%	0.16%	1.38%	0.03%	3.07%	0.20%	5.89
CMBS (Commercial Mortgage Backed Securities)	1.57%	-0.05%	1.74%	0.35%	2.30%	0.19%	4.10
ABS (Asset-Backed Securities)	0.97%	-0.04%	1.25%	-0.04%	1.30%	-0.10%	2.66
U.S. Corporate Investment Grade	2.04%	-0.55%	0.62%	-0.43%	2.60%	-0.42%	6.91
U.S. High Yield Corporates	0.67%	-0.52%	1.61%	0.22%	2.05%	0.41%	2.96
Emerging Market Debt	0.75%	-1.19%	2.05%	0.78%	2.39%	-0.01%	4.98
Municipal Bond Index	0.99%	N/A	0.02%	N/A	1.50%	N/A	6.28
Taxable Municipal Bond: Agg Eligible	3.25%	-0.20%	0.28%	-0.58%	3.56%	-0.34%	9.24
TIPS (Treasury Inflation Protected Securities)	2.18%	0.00%	1.87%	0.00%	3.50%	0.00%	6.80

*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.