Baird Advisors
Fixed Income Market Commentary
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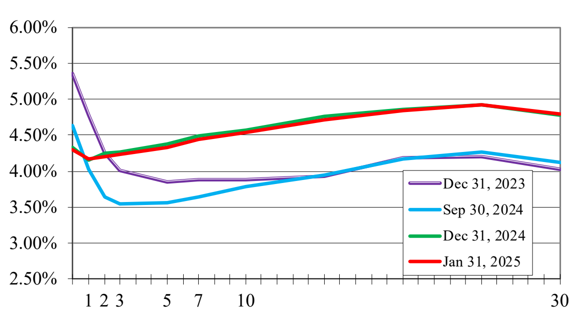
Treasury Yields Decline, Fed Holds Policy Rate Steady as Attention Turns to the Trump Administration's Policy Agenda

The 10yr Treasury yield rose in the first half of January before reversing and rallying into month end, finishing 4 bps lower at 4.54% with 2s10s slope unchanged. The initial upward yield pressure came from a stronger than expected December nonfarm payroll report of +226k (vs +165k estimate), pushing the 10yr up to 4.79%. Treasuries then rallied on better inflation data as YoY Core CPI came in below expectations (3.2% vs 3.3%). The Fed's preferred inflation measure, PCE Price Index, rose to 2.6% YoY in January from 2.4% the prior month, still above the Fed's 2.0% target. As expected, the FOMC voted unanimously at the January meeting to leave the policy rate range unchanged at 4.25-4.50%. The "solid" labor market and "somewhat elevated" inflation noted in the Fed's policy statement informed their decision to wait for more data, indicating a need to see a softening labor market or cooling inflation before considering further cuts. Mortgage rates finished the month at 6.95%, 86 bps higher than when the Fed easing began in September and well above the trailing 10yr average (4.60%). Tariff policy has also garnered additional focus as the Trump administration proposed plans to levy 25% tariffs on both Mexico and Canada and 10% on China. Changes to Federal aid disbursements and other cost-cutting efforts have been widely circulated as well.

Treasury Yields



Maturity	12/31/23	9/30/24	12/31/24	1/31/25	1 Mo Chg
3 Mo	5.36%	4.64%	4.33%	4.29%	-0.04%
1	4.78%	4.02%	4.16%	4.17%	0.01%
2	4.25%	3.64%	4.24%	4.20%	-0.04%
3	4.01%	3.55%	4.28%	4.24%	-0.04%
5	3.85%	3.56%	4.38%	4.33%	-0.05%
7	3.88%	3.65%	4.48%	4.44%	-0.04%
10	3.88%	3.78%	4.58%	4.54%	-0.04%
20	4.20%	4.18%	4.86%	4.84%	-0.02%
30	4.03%	4.12%	4.78%	4.79%	0.01%

Spreads Mixed in January

IG Corporate spreads finished -1 bps tighter with Financials performing best (-3 bps) and utilities lagging (+6 bps). Non-Agy CMBS continued its trend tighter (-4 bps) to finish January at +123. ABS spreads widened +3 bps in January, while HY and EM debt had a strong start to the year with spreads -26bps and -20bps respectively. Agy RMBS spreads were unchanged in January when removing the impact of changes to prepayment model assumptions. Model changes led to official data showing the sector -9 bps tighter.

Income Fosters Positive Returns in January

The Agg Index total return was 0.53% in January. Total returns were positive across major bond market sectors. Excess returns were positive across all sectors except ABS (-.06%) and Taxable Muni (-0.13%). CMBS led IG sectors with +0.23% excess returns followed by IG Corporate and US Agency both at +0.13%. HY and EM Debt led in excess returns for the month (+0.93% and +1.17%, respectively).

Option-Adjusted Spreads (in bps)

	12/31/23	9/30/24	12/31/24	1/31/25	1 Mo Chg
U.S. Aggregate Index	42	36	34	30	-4
U.S. Agency (non-mortgage)	17	16	12	8	-4
Mortgage and ABS Sectors					
U.S. Agency RMBS (Pass-throughs)*	47	42	43	34	0*
U.S. Agency CMBS	48	39	35	31	-4
U.S. Non-Agency CMBS	203	149	127	123	-4
Asset-Backed Securities	68	64	44	47	3
Corporate Sectors					
U.S. Investment Grade	99	89	80	79	-1
Industrial	90	87	78	76	-2
Utility	105	92	82	88	6
Financial Institutions	112	90	82	79	-3
Non-Corporate Credit	55	54	55	52	-3
U.S. High Yield Corporates	323	295	287	261	-26
Emerging Market Debt	598	470	393	373	-20

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	2024 Total Return	2024 Excess Return	Effective Duration (years)
U.S. Aggregate Index	0.53%	0.05%	1.25%	0.78%	6.08
U.S. Gov't/Credit Index	0.53%	0.05%	1.18%	0.88%	6.10
U.S. Intermediate Gov't/Credit Index	0.57%	0.05%	3.00%	0.66%	3.72
U.S. 1-3 Yr. Gov't/Credit Index	0.46%	0.04%	4.36%	0.23%	1.84
U.S. Treasury	0.52%	0.00%	0.58%	0.00%	5.80
U.S. Agency (Non-Mortgage)	0.55%	0.13%	3.16%	0.38%	3.21
U.S. Agency RMBS (Pass-Throughs)	0.51%	0.04%	1.20%	0.37%	6.20
CMBS (Commercial Mortgage Backed Securities)	0.72%	0.23%	4.68%	2.80%	4.10
ABS (Asset-Backed Securities)	0.32%	-0.06%	5.02%	1.53%	2.64
U.S. Corporate Investment Grade	0.55%	0.13%	2.13%	2.46%	6.81
U.S. High Yield Corporates	1.37%	0.93%	8.19%	5.02%	3.01
Emerging Market Debt	1.62%	1.17%	14.80%	13.41%	4.97
Municipal Bond Index	0.50%	N/A	1.05%	N/A	6.28
Taxable Municipal Bond: Agg Eligible	0.30%	-0.13%	0.09%	2.42%	9.13
TIPS (Treasury Inflation Protected Securities)	1.29%	0.00%	1.84%	0.00%	6.68

*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.