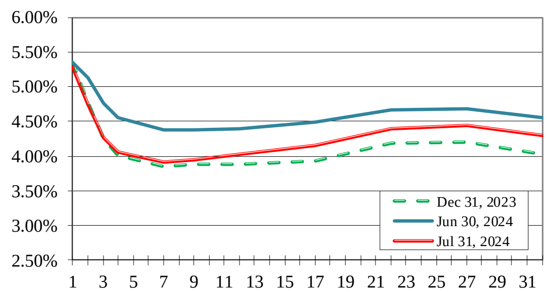
Baird Advisors
Fixed Income Market Commentary
July 2024

Treasury Yields Decline as Inflation Cools and Fed Signals Forthcoming Cuts

The 10yr Treasury yield fell 37 bps in July to 4.03%, which is down 68bps from the 4.71% YTD peak in late-April. The 2yr yield fell even more, slipping 50 bps narrowing the 2s10s curve inversion to -23 bps from -36 bps MoM. Easing inflation pressures have been the primary catalyst for the downward yield trend. Most recently, the June CPI reading of -0.1% MoM was the first negative monthly reading since May of 2020, as transportation and shelter costs eased. The Fed's preferred inflation measure (PCE price index) also continued its decline, registering 2.5% YoY from a prior reading of 2.6%. Although the Fed held its policy range steady in July at 5.25% - 5.50%, where it has resided for the past 12-months, the post-meeting FOMC statement emphasized that the Fed is now "attentive to the risks to both sides of its dual mandate" (stable inflation & full employment), a shift from primarily an inflation focus for the past two years. Employment has held relatively firm, with June payroll gains of 206k exceeding consensus estimates, but the prior two months data was revised lower by 111k. The unemployment rate ticked up to 4.1% from 4.0%, continuing a 3-month up trend and sat 0.7% above the 3.4% cycle low. Barring an inflation surprise, Fed Chair Powell seemed supportive of a September rate cut in the recent FOMC press conference, which drove the futures market to price in a September rate cut and two more before year-end.

Treasury Yields



Maturity	12/31/23	3/31/24	5/31/24	6/30/24	7/31/24	1 Mo Chg	YTD Chg
3 Mo	5.36%	5.38%	5.41%	5.36%	5.29%	-0.07%	-0.07%
1	4.78%	5.04%	5.19%	5.13%	4.76%	-0.37%	-0.02%
2	4.25%	4.62%	4.88%	4.76%	4.26%	-0.50%	0.01%
3	4.01%	4.41%	4.68%	4.55%	4.06%	-0.49%	0.05%
5	3.85%	4.21%	4.51%	4.38%	3.92%	-0.46%	0.07%
7	3.88%	4.21%	4.51%	4.38%	3.95%	-0.43%	0.07%
10	3.88%	4.20%	4.50%	4.40%	4.03%	-0.37%	0.15%
20	4.20%	4.45%	4.73%	4.66%	4.39%	-0.27%	0.19%
30	4.03%	4.35%	4.65%	4.56%	4.31%	-0.25%	0.28%

Spread Changes Muted, Agency RMBS Outperforms

Agency RMBS tightened -4 bps in July on favorable supply/demand conditions. Non-Agency CMBS widened 1 bps for the month but remains -48 bps tighter YTD. ABS spreads tightened -3 bps for the month. IG Corporate spreads were -1 bps tighter and stand -6 bps tighter YTD. Spreads widened in US HY and EM Debt on the month.

Strong July Total Returns Across the Bond Market

The Agg Index produced positive returns for the third consecutive month, up 2.34% in July and 5.06% for the trailing 3 months resulting in YTD total returns becoming positive again, up 1.61%. Agency RMBS led all sectors in excess return for July (+0.42%). CMBS and ABS each produced +0.07% of excess returns in July. Municipal's total returns (+0.91%) lagged taxable sectors during the July rally.

Option-Adjusted Spreads (in bps)

	12/31/23	3/31/24	5/31/24	6/30/24	7/31/24	1 Mo Chg	YTD Chg
U.S. Aggregate Index	42	39	37	39	38	-1	-4
U.S. Agency (non-mortgage)	17	15	13	13	14	1	-3
Mortgage and ABS Sectors							
U.S. Agency RMBS (Pass-throughs)	47	49	50	48	44	-4	-3
U.S. Agency CMBS	48	41	39	40	41	1	-7
U.S. Non-Agency CMBS	203	152	148	154	155	1	-48
Asset-Backed Securities	68	55	54	57	60	3	-8
Corporate Sectors							
U.S. Investment Grade	99	90	85	94	93	-1	-6
Industrial	90	85	81	90	90	0	0
Utility	105	97	93	104	102	-2	-3
Financial Institutions	112	96	88	97	97	0	-15
Non-Corporate Credit	55	53	50	53	54	1	-1
U.S. High Yield Corporates	323	299	308	309	314	5	-9
Emerging Market Debt	598	527	502	513	524	11	-74

Source: Bloomberg Indices

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	2.34%	0.13%	5.06%	0.21%	1.61%	0.33%	6.14
U.S. Gov't/Credit Index	2.24%	0.03%	4.78%	-0.07%	1.55%	0.36%	6.30
U.S. Intermediate Gov't/Credit Index	1.88%	0.03%	3.93%	0.05%	2.37%	0.34%	3.77
U.S. 1-3 Yr. Gov't/Credit Index	1.19%	0.04%	2.49%	0.05%	2.58%	0.16%	1.84
U.S. Treasury	2.19%	0.00%	4.72%	0.00%	1.31%	0.00%	6.00
U.S. Agency (Non-Mortgage)	1.48%	0.05%	3.26%	0.12%	2.33%	0.28%	3.03
U.S. Agency RMBS (Pass-Throughs)	2.64%	0.42%	5.91%	1.00%	1.63%	0.18%	5.87
CMBS (Commercial Mortgage Backed Securities)	2.05%	0.07%	4.60%	0.39%	3.61%	1.81%	4.25
ABS (Asset-Backed Securities)	1.36%	0.07%	2.99%	0.17%	3.05%	0.80%	2.75
U.S. Corporate Investment Grade	2.38%	0.08%	4.96%	-0.20%	1.89%	0.94%	7.01
U.S. High Yield Corporates	1.94%	0.36%	4.04%	0.60%	4.58%	2.36%	3.04
Emerging Market Debt	1.78%	-0.13%	3.55%	-0.66%	7.82%	6.21%	4.86
Municipal Bond Index	0.91%	N/A	2.16%	N/A	0.50%	N/A	6.04
Taxable Municipal Bond: Agg Eligible	2.84%	0.07%	5.77%	-0.51%	1.60%	1.40%	9.45
TIPS (Treasury Inflation Protected Securities)	1.78%	0.00%	4.34%	0.00%	2.50%	0.00%	6.78

*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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