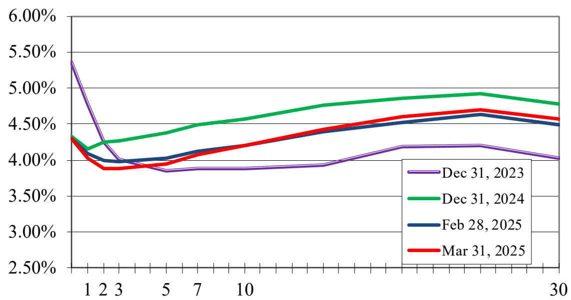
Baird Advisors
Fixed Income Market Commentary
March 2025

Treasury Yields Decline in Q1 Amid Policy Uncertainty and Lower Economic Growth Forecasts

The 10yr Treasury yield was unchanged in March but declined 37 bps for the quarter. The 2yr Treasury declined 10 bps for the month and 35 bps for the quarter, which kept the 2s10s curve slope little changed in Q1. As expected, the Fed held policy rates steady (4.25% - 4.50%) at the March FOMC meeting, opting for a "wait-and-see" stance given the significant policy uncertainty. Fed Chair Powell did note sufficiently strong "hard data" such as the currently low unemployment rate (4.1%), solid recent growth (2.5% Real GDP for 2024) and progress toward the Fed's 2% inflation target (2.5% YoY PCE Price Index) as reasons for holding steady. Yet, their updated March Summary of Economic Projections for YE 2025 reflected slower growth and sticky inflation expectations; with the unemployment rate to rise to 4.4% (from 4.3% previously), growth to slow (to 1.7% from 2.1%) and inflation to rise to 2.7% (from their December forecast of 2.5%). Policy uncertainty informed their decision, as President Trump's tariff plans are implemented and DOGE-driven spending cuts are made, even as extensions of the 2017 tax cuts are considered. The Fed also decided to slow the pace of balance sheet runoff, reducing Treasuries to $5B from $25B per month while leaving the Agency MBS monthly cap unchanged at $35B.

Treasury Yields



Maturity	12/31/23	12/31/24	2/28/25	3/31/25	1 Mo Chg	Q1 Chg
3 Mo	5.36%	4.33%	4.31%	4.30%	-0.01%	-0.03%
1	4.78%	4.16%	4.09%	4.03%	-0.06%	-0.13%
2	4.25%	4.24%	3.99%	3.89%	-0.10%	-0.35%
3	4.01%	4.28%	3.97%	3.88%	-0.09%	-0.40%
5	3.85%	4.38%	4.02%	3.95%	-0.07%	-0.43%
7	3.88%	4.48%	4.12%	4.08%	-0.04%	-0.40%
10	3.88%	4.58%	4.21%	4.21%	0.00%	-0.37%
20	4.20%	4.86%	4.53%	4.60%	0.07%	-0.26%
30	4.03%	4.78%	4.49%	4.57%	0.08%	-0.21%

Spreads Wider for Month and Quarter

Agy RMBS were +2 bps wider in Q1 when accounting for the index model change. Non-Agy CMBS widened +13 bps for the month, most among IG sectors, and +12 bps for the quarter. IG Corporates widened +7 bps for the month and +14 bps for the quarter amid heavy issuance and trading volumes. US High Yield (+60 bps Q1) and EM Debt (+40 bps Q1) widened most, with much of the move occurring in March.

Positive Q1 Total Returns but Negative Excess Returns

The Agg Index total return was positive for the month (+0.04%) and Q1 (+2.78%). A closer inspection reveals negative excess returns across the board in March and Q1 as spreads widening more than offset the benefit of spread carry. March excess returns for Agy RMBS and CMBS stood at -0.27% and -0.25% respectively. US Corporate excess returns were -0.42% for the month and -0.85% for Q1. YTD excess returns for Long Corporates now stand at -1.99% vs -0.29% for Intermediate Corporates as longer maturities led the spread widening.

Option-Adjusted Spreads (in bps)

	12/31/23	12/31/24	2/28/25	3/31/25	1 Mo Chg	Q1 Chg
U.S. Aggregate Index	42	34	32	35	3	1
U.S. Agency (non-mortgage)	17	12	8	11	3	-1
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)*	47	43	31	36	5	2*
U.S. Agency CMBS	48	35	33	37	4	2
U.S. Non-Agency CMBS	203	127	126	139	13	12
Asset-Backed Securities	68	44	50	60	10	16
Corporate Sectors						
U.S. Investment Grade	99	80	87	94	7	14
Industrial	90	78	85	92	7	14
Utility	105	82	97	103	6	21
Financial Institutions	112	82	87	95	8	13
Non-Corporate Credit	55	55	56	57	1	2
U.S. High Yield Corporates	323	287	280	347	67	60
Emerging Market Debt	598	393	399	433	34	40

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	YTD Total Return	YTD Excess Return	Effective Duration (years)
U.S. Aggregate Index	0.04%	-0.18%	2.78%	-0.23%	6.09
U.S. Gov't/Credit Index	0.05%	-0.15%	2.70%	-0.29%	6.20
U.S. Intermediate Gov't/Credit Index	0.44%	-0.06%	2.42%	-0.08%	3.76
U.S. 1-3 Yr. Gov't/Credit Index	0.46%	-0.01%	1.63%	0.03%	1.87
U.S. Treasury	0.23%	0.00%	2.92%	0.00%	5.92
U.S. Agency (Non-Mortgage)	0.28%	-0.12%	2.11%	0.00%	3.27
U.S. Agency RMBS (Pass-Throughs)	-0.02%	-0.27%	3.06%	-0.07%	5.94
CMBS (Commercial Mortgage Backed Securities)	0.26%	-0.25%	2.57%	-0.07%	4.07
ABS (Asset-Backed Securities)	0.23%	-0.18%	1.53%	-0.29%	2.64
U.S. Corporate Investment Grade	-0.29%	-0.42%	2.31%	-0.85%	6.88
U.S. High Yield Corporates	-1.02%	-1.51%	1.00%	-1.13%	3.08
Emerging Market Debt	-0.77%	-1.11%	1.59%	-1.14%	4.92
Municipal Bond Index	-1.69%	N/A	-0.22%	N/A	6.51
Taxable Municipal Bond: Agg Eligible	-0.71%	-0.62%	2.83%	-0.99%	9.15
TIPS (Treasury Inflation Protected Securities)	0.64%	0.00%	4.17%	0.00%	6.71

*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.