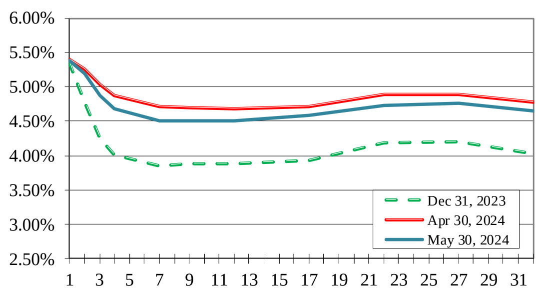
Baird Advisors
Fixed Income Market Commentary
May 2024

Yields Fall as Labor Market and Inflation Cools after Q1 Upside Surprise

Treasury yields declined 15 to 20bps across the yield curve in May, a reprieve from the upward YTD trend. Yields on 2yr and 10yr maturities fell in near-lockstep manner, leaving the persistent 2s/10s curve inversion relatively unchanged (-38 bps). As anticipated, the Fed opted to hold rates steady and slow (taper) the Quantitative Tightening (QT) balance sheet runoff at the May 1 FOMC meeting. Although their official statement said that "there has been a lack of further progress toward the Committee's 2% inflation objective" given the higher-than-expected inflation in Q1, in the press conference following the meeting, Chair Powell provided some dovish relief by saying the next rate move was unlikely to be a hike. A weaker than expected April jobs report (175k vs 240k est) followed soon after the May 1 FOMC meeting. April inflation was reported later in the month and both CPI and PCE price indices showed some modest cooling with no upside surprise. These signs of cooling, both the labor market and inflation, were the primary drivers of the modest move lower in Treasury yields though rates were volatile during the month with the 10yr Treasury trading in a 35bp range.

Treasury Yields



Maturity	12/31/22	12/31/23	4/30/24	5/31/24	1 Mo Chg	YTD Chg
3 Mo	4.41%	5.36%	5.41%	5.41%	0.00%	0.05%
1	4.73%	4.78%	5.25%	5.19%	-0.06%	0.41%
2	4.43%	4.25%	5.04%	4.88%	-0.16%	0.63%
3	4.23%	4.01%	4.88%	4.68%	-0.20%	0.67%
5	4.01%	3.85%	4.72%	4.51%	-0.21%	0.66%
7	3.97%	3.88%	4.71%	4.51%	-0.20%	0.63%
10	3.88%	3.88%	4.68%	4.50%	-0.18%	0.62%
20	4.15%	4.20%	4.90%	4.73%	-0.17%	0.53%
30	3.97%	4.03%	4.79%	4.65%	-0.14%	0.62%

Spreads Grind Tighter as Trend Continues

Spreads tightened modestly across all major sectors except ABS and HY Corporates. The move tighter was largest in non-Agency CMBS (-9 bps), a sector that continues to offer outsized spread, especially among its lower rated subset. Agency RMBS also tightened in May (-6 bps) but remains the only major sector wider YTD (+3 bps). IG Corporate debt tightened in May (-2 bps), led by Financials (-5 bps).

Agency RMBS Leads in May but Lags YTD

Nominal returns were positive across the board for May aside from the Municipal market, which had outperformed in the first 4 months of the year but succumbed to heavier supply in May. Agency RMBS produced +0.49% of excess return in May, leading all sectors but remained the sole major sector with negative excess returns YTD (-0.29%). CMBS and IG Corporate debt each offered compelling excess return in May (+0.34% and +0.30%, respectively) adding to their YTD outperformance.

Option-Adjusted Spreads (in bps)

	12/31/22	12/31/23	4/30/24	5/31/24	1 Mo Chg	YTD Chg
U.S. Aggregate Index	51	42	40	37	-3	-5
U.S. Agency (non-mortgage)	26	17	13	13	0	-4
Mortgage and ABS Sectors						
U.S. Agency RMBS (Pass-throughs)	51	47	56	50	-6	3
U.S. Agency CMBS	52	48	40	39	-1	-9
U.S. Non-Agency CMBS	179	203	157	148	-9	-55
Asset-Backed Securities	76	68	53	54	1	-14
Corporate Sectors						
U.S. Investment Grade	130	99	87	85	-2	-14
Industrial	125	90	83	81	-2	-9
Utility	129	105	95	93	-2	-12
Financial Institutions	140	112	93	88	-5	-24
Non-Corporate Credit	66	55	51	50	-1	-5
U.S. High Yield Corporates	469	323	301	308	7	-15
Emerging Market Debt	687	598	504	502	-2	-96

Source: Bloomberg Indices

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	1.70%	0.21%	-1.64%	0.33%	6.15
U.S. Gov't/Credit Index	1.60%	0.11%	-1.53%	0.52%	6.21
U.S. Intermediate Gov't/Credit Index	1.21%	0.09%	-0.31%	0.38%	3.76
U.S. 1-3 Yr. Gov't/Credit Index	0.73%	0.03%	0.81%	0.14%	1.86
U.S. Treasury	1.46%	0.00%	-1.85%	0.00%	5.92
U.S. Agency (Non-Mortgage)	0.98%	0.05%	0.07%	0.22%	3.04
U.S. Agency RMBS (Pass-Throughs)	2.00%	0.49%	-2.12%	-0.29%	6.14
CMBS (Commercial Mortgage Backed Securities)	1.54%	0.34%	0.58%	1.72%	4.25
ABS (Asset-Backed Securities)	0.93%	0.12%	0.99%	0.73%	2.65
U.S. Corporate Investment Grade	1.87%	0.30%	-1.12%	1.39%	6.92
U.S. High Yield Corporates	1.10%	0.10%	1.63%	1.82%	3.19
Emerging Market Debt	1.49%	0.23%	5.67%	6.93%	4.82
Municipal Bond Index	-0.29%	N/A	-1.91%	N/A	6.10
Taxable Municipal Bond: Agg Eligible	1.89%	-0.07%	-2.13%	1.75%	9.23
TIPS (Treasury Inflation Protected Securities)	1.72%	0.00%	-0.08%	0.00%	6.62

*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.

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