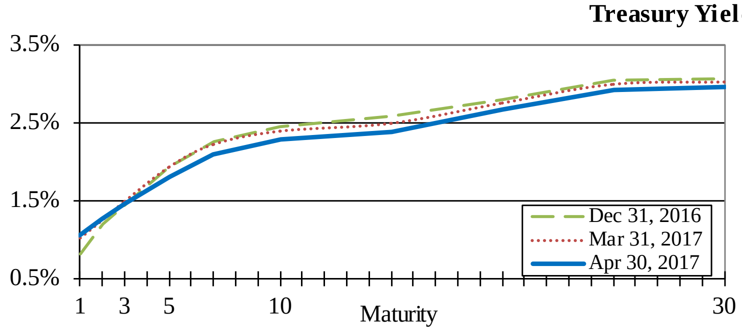
Baird Advisors
Fixed Income Market Comments
April 2017

Yields Fall, Curve Flattens on Slow Growth; Market Expects Fed to Continue Normalization

Treasury yields fell and the curve flattened in April on continued signs of modestly slowing economic growth. 10-year Treasury yields hit a YTD low of 2.18% before rebounding to end the month down 16bps at 2.28%. A weaker-than-expected nonfarm jobs report (March +98k actual vs. +180k consensus forecast), declining retail sales (-0.2%), and a mere +0.7% annualized pace of Q1 GDP growth all contributed to the lower move in interest rates. Lower headline inflation (CPI -0.3% MoM, with YoY falling from 2.7% to 2.4%) driven by falling energy prices also contributed to lower rates. In spite of a flurry of political activity, including work to reboot the health care reform bill and a broad tax reform outline, investors increasingly see any fiscal stimulus from Washington as being delayed and diluted versus their original assumptions. Market sentiment was helped by the results of the first round of the French presidential election as Emmanuel Macron, the more moderate candidate, took the most votes and polls suggest he will defeat far-right candidate Marine Le Pen on May 7th. In spite of somewhat slower economic growth, the market expects the Fed will continue normalizing the Fed Funds rate, with Boston Fed President Eric Rosengren suggesting that "the economy is strong enough" to sustain another rate hike. While odds of a Fed Funds rate hike in May remain low, markets are pricing a 70% chance of a move at the June meeting.

Treasury Yields



Maturity	12/31/16	3/31/17	4/30/17	1Mo Chg	YTD Chg
1	0.81%	1.02%	1.06%	0.04%	0.25%
2	1.19%	1.25%	1.27%	0.02%	0.08%
3	1.45%	1.49%	1.45%	-0.04%	0.00%
5	1.93%	1.93%	1.81%	-0.12%	-0.12%
7	2.25%	2.22%	2.09%	-0.13%	-0.16%
10	2.44%	2.39%	2.28%	-0.11%	-0.16%
30	3.07%	3.02%	2.95%	-0.07%	-0.12%

Investment-Grade Yield Spreads Tighten Slightly

Investment-Grade Corporate yield spreads continued tightening (another 2 bps last month) as fixed income mutual funds and ETFs saw strong inflows and credit fundamentals remain solid. ABS also tightened 2 bps; however, agency mortgage-backed securities were weighed down by discussion in the Fed's meeting minutes that a "passive and predictable" reduction or elimination of reinvestment in MBS and Treasury securities on their balance sheet could begin before year end. Agency MBS have widened 12 bps so far this year.

Corporates Outperform

All major sectors posted positive returns in April and spread sectors outperformed equal-duration Treasuries. Investment-grade corporates (+1.07%) were the best performing investment-grade sector, while high yield corporates (+1.15%) delivered the strongest performance overall as the sector moved higher in tandem with equity markets.

Option-Adjusted Spreads (in bps)

	12/31/16	3/31/17	4/30/17	1Mo Chg	YTD Chg
U.S. Aggregate Index	43	44	43	-1	0
U.S. Agency (non-mortgage)	21	18	17	-1	-4
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	15	27	27	0	12
Asset-Backed Securities	59	54	52	-2	-7
CMBS	75	77	78	1	3
Corporate Sectors					
U.S. Investment Grade	123	118	116	-2	-7
Industrial	125	121	119	-2	-6
Utility	117	116	115	-1	-2
Financial Institutions	120	113	111	-2	-9
U.S. High Yield	409	383	371	-12	-38

Sources: Bloomberg Barclays Indices

Total Returns of Selected Bloomberg Barclays Indices and Subsectors

Bloomberg Barclays Index/Sector	April	YTD
U.S. Aggregate Index	0.77%	1.59%
U.S. Gov't/Credit Index	0.82%	1.79%
U.S. Intermediate Gov't/Credit Index	0.62%	1.41%
U.S. 1-3 Yr. Gov't/Credit Index	0.18%	0.59%
U.S. Treasury	0.69%	1.37%
U.S. Agency	0.51%	1.27%
MBS (Mortgage-Backed Securities)	0.65%	1.13%
CMBS (Commercial Mortgage-Backed Securities)	0.79%	1.66%
ABS (Asset-Backed Securities)	0.32%	0.85%
U.S. Corporate - Investment Grade	1.07%	2.30%
Corporate High Yield	1.15%	3.89%
Municipal Bond Index	0.73%	2.32%
TIPS (Treasury Inflation Protected Securities)	0.59%	1.86%

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 Barclays 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 Barclays 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 Barclays Intermediate 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 with maturities between one and ten years.

The Bloomberg Barclays Government/Credit Intermediate Index (1 – 3 yr.) 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 Barclays 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 Barclays CMBS ERISA-Eligible Index is the ERISA-eligible component of the Bloomberg Barclays 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 Barclays 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.

The Bloomberg Barclays 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 Barclays 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.