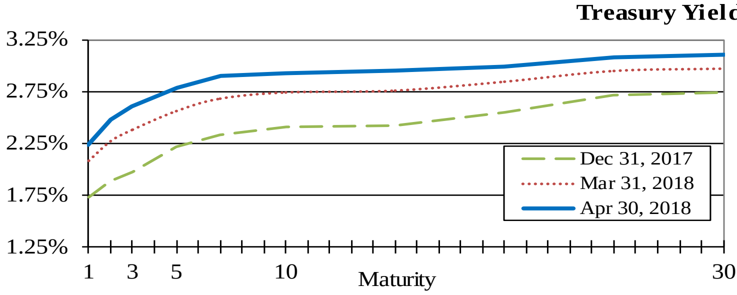
Baird Advisors
Fixed Income Market Commentary
April 2018

Treasury Yields Rise as Inflation Inches Higher

The 10-yr Treasury yield closed the month 19 bps higher at 2.93%, after exceeding 3.0% intra-month for the first time since 2014 (with a 3.02% close on April 25th) as inflation inched higher. The Fed's March meeting minutes acknowledged concerns that recent trade issues pose downside risks for the economy while at the same time the committee expressed growing confidence in achieving its 2% inflation target. March Core Personal Consumption Expenditure (PCE) Index rose 1.9% YoY, up from 1.6% in the prior month, contributing to a rise in market-implied odds for 3 additional rate hikes this year from 30% to 50%. The upward pressure on rates in April was also partly due to the most recent CBO estimates which projected rising annual budget deficits, reaching more than one trillion in 2020, two years earlier than previously forecasted. The CBO projects 3.3% GDP growth in 2018 before slowing to less than 2.0% in 2020. Q1 U.S. GDP rose at a 2.3% annualized rate, beating the consensus estimate of 2.0%, but continuing a pattern of below-trend growth to start the year. The market consensus for 2Q GDP still anticipates a return to over 3.0% growth. Modest slowing was also evident in the March nonfarm payroll report as hiring slowed to 103,000 new jobs, below both the 185,000 consensus estimate and the 326,000 new hires in February. President Trump nominated Michelle Bowman and Richard Clarida (Vice Chair) to the Fed in hopes of filling two of the vacancies on the Fed's Board of Governors (pending Senate confirmation). Separately, the NY Fed selected John Williams to succeed William Dudley as president in June, filling the last of the three most important seats at the Fed.

Treasury Yields



Maturity	12/31/17	3/31/18	4/30/2018	1Mo Chg	YTD Chg
1	1.73%	2.08%	2.23%	0.15%	0.50%
2	1.88%	2.27%	2.48%	0.21%	0.60%
3	1.97%	2.38%	2.61%	0.23%	0.64%
5	2.21%	2.56%	2.79%	0.23%	0.58%
7	2.33%	2.68%	2.90%	0.22%	0.57%
10	2.41%	2.74%	2.93%	0.19%	0.52%
30	2.74%	2.97%	3.10%	0.13%	0.36%

Spreads Tighten Modestly, High Yield Snaps Back

Investment-grade spread sectors tightened modestly, recouping some of the Q1 widening. Asset-Backed Securities (ABS) tightened 5 bps in the month as consumer credit fundamentals remain solid and new issue supply remained manageable. The High Yield Corporate sector is one of the few sectors to tighten YTD, driven by the outperformance of the lowest quality segments within the sector as well as low supply.

Negative Returns Continue as Rates Rise

Rising Treasury yields pushed all investment grade sectors further into negative territory YTD. Despite modestly tighter spreads, Investment Grade Corporates (with a longer duration, see table) were the worst performing sector overall with -0.93% returns in April, bringing YTD returns to -3.22%. Shorter-duration sectors such as ABS, however, have had much more modest drops in value (-0.04% MTD, -0.42% YTD). High Yield managed to post a positive April return (+0.65%), but still has declined modestly in value YTD (-0.21%).

Option-Adjusted Spreads (in bps)

	12/31/17	3/31/18	4/30/18	1Mo Chg	YTD Chg
U.S. Aggregate Index	36	41	40	-1	4
U.S. Agency (non-mortgage)	14	12	13	1	-1
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	25	29	28	-1	3
U.S. Agency CMBS	35	41	41	0	6
U.S. Non-Agency CMBS	79	83	80	-3	1
Asset-Backed Securities	36	48	43	-5	7
Corporate Sectors					
U.S. Investment Grade	93	109	108	-1	15
Industrial	98	111	110	-1	12
Utility	92	104	102	-2	10
Financial Institutions	85	106	103	-3	18
U.S. High Yield	343	354	338	-16	-5

Source: Bloomberg Barclays Indices

Total Returns of Selected Barclays Indices and Subsectors

Barclays Index/Sector	April	YTD 2018	Effective Duration
U.S. Aggregate Index	-0.74%	-2.19%	6.05 yrs.
U.S. Gov't/Credit Index	-0.85%	-2.42%	6.42 yrs.
U.S. Intermediate Gov't/Credit Index	-0.52%	-1.50%	3.94 yrs.
U.S. 1-3 Yr. Gov't/Credit Index	-0.10%	-0.30%	1.92 yrs.
U.S. Treasury	-0.81%	-1.98%	6.04 yrs.
U.S. Agency	-0.59%	-1.12%	3.79 yrs.
MBS (Mortgage Backed Securities)	-0.50%	-1.69%	5.28 yrs.
CMBS (Commercial Mortgage Backed Securities)	-0.69%	-2.00%	5.34 yrs.
ABS (Asset Backed Securities)	-0.04%	-0.42%	2.08 yrs.
U.S. Corporate - Investment Grade	-0.93%	-3.22%	7.29 yrs.
Corporate High Yield	0.65%	-0.21%	3.95 yrs.
Municipal Bond Index	-0.36%	-1.46%	6.04 yrs.
TIPS (Treasury Inflation Protected Securities)	-0.06%	-0.85%	5.38 yrs.

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.