Baird Advisors
Fixed Income Market Comments
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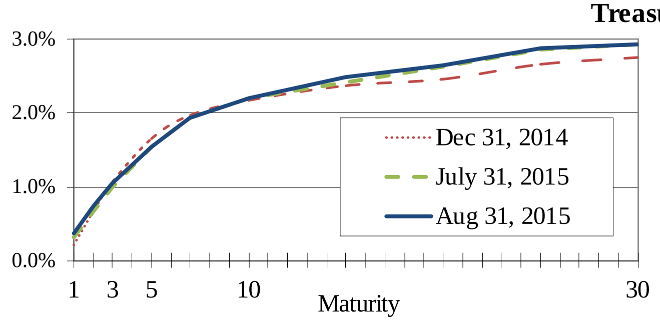
China Devalues Currency, Market Volatility Spikes

The Central Bank of China unexpectedly devalued the yuan by nearly 3% against the US Dollar, triggering a bout of global market volatility and worries that the growth slowdown in the world's second largest economy was worse than thought with negative ramifications for an already fragile global growth outlook. The 10-year Treasury yield traded in a 39 bp range from 1.90% to 2.29% only to end the month unchanged at 2.20%. Equity market volatility (as measured by the VIX index) hit a post-crisis high intraday as the S&P 500 fell by more than 11% midmonth before rebounding off the lows. In the midst of global volatility, U.S. growth data has been solid (Aug. nonfarm payrolls +215K, Q2 GDP revised from +2.3% to +3.7%); however, inflation remains tepid (July CPI +0.2% YoY) as energy prices fell. Lower inflation expectations coupled with a worse than expected downturn in China has caused some market participants to postpone their expectations for the first Fed Funds rate increase from September to later in the year or into 2016.

Treasury Yields



Maturity	Dec 31, 2014	Jul 31, 2015	Aug 31, 2015	1Mo Change	YTD Change
1	0.21%	0.31%	0.37%	0.06%	0.16%
2	0.66%	0.67%	0.74%	0.07%	0.08%
3	1.07%	0.99%	1.05%	0.06%	-0.02%
5	1.65%	1.55%	1.54%	-0.01%	-0.11%
7	1.97%	1.94%	1.93%	-0.01%	-0.04%
10	2.17%	2.20%	2.20%	0.00%	0.03%
30	2.75%	2.93%	2.93%	0.00%	0.18%

Spreads Widen on Macro Uncertainty

Yield spreads widened on heightened macro uncertainty as investors sought the liquidity and safety of U.S. Government securities. August was the lightest month of Investment Grade Corporate gross issuance this year at $54B, yet corporate spreads still widened 9 bps (see table at right) on China-related concerns. Within Corporate Credit, sectors with more exposure to falling commodity prices, such as Industrials, widened more than those with limited direct exposure (i.e. Financials). Corporate High Yield had a very volatile month, with spreads widening by as much as 74 bps to 587 bps on August 24th before recovering (with equities) to end the month at 544 bps. Spreads on Agency debentures, Agency Pass-throughs, and Asset-Backed Securities tightened marginally as investors sought exposure in higher quality, more liquid sectors.

Option-Adjusted Spreads (in bps)

	12/31/14	7/31/15	8/31/15	1Mo Change	YTD Change
U.S. Aggregate Index	48	55	57	2	9
U.S. Agency (non-mortgage)	16	18	14	-4	-2
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	27	28	27	-1	0
Asset-Backed Securities	58	63	61	-2	3
CMBS	98	102	112	10	14
Corporate Sectors					
U.S. Investment Grade	131	154	163	9	32
Industrial	140	164	177	13	37
Utility	119	143	149	6	30
Financial Institutions	117	138	142	4	25
U.S. High Yield	483	513	544	31	61

Source: Barclays

Mixed Returns, Spread Sectors Lag

Treasuries (+0.04%) and Agencies (+0.05%) posted near flat returns in August while Investment Grade Corporates (-0.59%) and Commercial Mortgage-Backed Securities (-0.32%) lagged. TIPS (-0.76%) underperformed this month as inflation expectations declined. High Yield Corporates mirrored equities and trailed the pack (-1.74%) as a further slowing of global growth led by China stressed credit fundamentals on highly levered companies and global macro worries drove additional negative fund flows.

Total Returns of Selected Barclays Indices and Subsectors

Barclays Index/Sector	August	YTD
U.S. Aggregate Index	-0.14%	0.45%
U.S. Gov't/Credit Index	-0.23%	0.20%
U.S. Intermediate Gov't/Credit Index	-0.08%	1.09%
U.S. 1-3 Yr. Gov't/Credit Index	-0.06%	0.72%
U.S. Treasury	0.04%	0.91%
U.S. Agency	0.05%	1.10%
MBS (Mortgage-Backed Securities)	0.08%	1.02%
CMBS (Commercial Mortgage-Backed Securities)	-0.32%	1.02%
ABS (Asset-Backed Securities)	0.10%	1.37%
U.S. Corporate - Investment Grade	-0.59%	-0.84%
Corporate High Yield	-1.74%	0.15%
Municipal Bond Index	0.20%	1.04%
TIPS (Treasury Inflation Protected Securities)	-0.76%	-0.22%

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 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 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 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 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 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 Barclays CMBS ERISA-Eligible Index is the ERISA-eligible component of the 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 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 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 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.