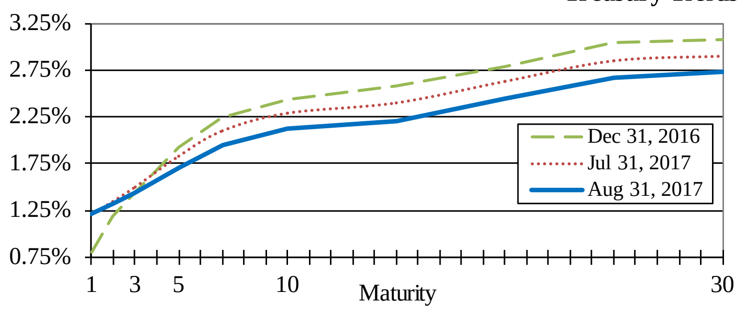
Baird Advisors
Fixed Income Market Comments
August 2017

Treasuries Rally into Rising Geopolitical Risks

Treasury yields moved in a fairly steady downward path in August with the greatest yield declines occurring among intermediate and longer maturities; short yields were little changed. Treasuries served as a safe haven in a heightened geopolitical risk environment as N. Korea escalated tensions with the U.S. and fired a missile over Japan, despite strong warnings from President Trump and other global leaders. Treasuries were further supported by continued benign inflation, as the Fed's preferred gauge of inflation, the Personal Consumption Expenditure Core Price Index, rose just 1.4% YoY (even as 2Q GDP was revised higher to 3.0% from 2.6%). There were no new monetary policy insights from the Fed's July meeting minutes nor from Janet Yellen at the Jackson Hole, WY summit, leaving the market expectation of an official announcement of balance sheet normalization for the September FOMC meeting. Congress returns from the Labor Day break to a full agenda. Top priorities will include providing emergency funds for Hurricane Harvey victims, lifting the federal debt ceiling to avoid a technical government default and passing a budget that avoids a government shutdown. Markets will be watching the legislative process closely for progress on the administration's tax reform agenda.

Treasury Yields



Maturity	12/31/16	7/31/17	8/31/17	1Mo Chg	YTD Chg
1	0.81%	1.21%	1.22%	0.01%	0.41%
2	1.19%	1.35%	1.32%	-0.03%	0.13%
3	1.45%	1.50%	1.43%	-0.07%	-0.02%
5	1.93%	1.83%	1.71%	-0.12%	-0.22%
7	2.25%	2.10%	1.95%	-0.15%	-0.30%
10	2.44%	2.29%	2.12%	-0.17%	-0.32%
30	3.07%	2.90%	2.73%	-0.17%	-0.34%

Corporate Credit Spreads Give Back Some YTD Tightening

Corporate credit spreads widened 8bps this month to 110bps, giving back roughly one third of the prior YTD tightening. While heightened geopolitical risk contributed to some of the widening in the sector, large new issue supply in the industrial sector also contributed. AT&T, British American Tobacco, and Amazon each sold bonds in $22.5B, $17.25B, and $16.0B deals to fund M&A activity, making those the 3rd, 8th and 15th largest bond deals of all time. Securitized sectors such as CMBS and ABS tightened a few basis points this month as investors were drawn to these higher-quality sectors.

CMBS Sector Outperforms, Corporate High Yield Lags

CMBS was the top performing sector overall in August (+1.13%) as tighter spreads and a flattening yield curve boosted returns. High Yield Corporate bond returns, however, were slightly negative as investor demand for low-quality issues abated.

Option-Adjusted Spreads (in bps)

	12/31/16	7/31/17	8/31/17	1Mo Chg	YTD Chg
U.S. Aggregate Index	43	40	42	2	-1
U.S. Agency (non-mortgage)	21	15	16	1	-5
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	15	28	30	2	15
U.S. Agency CMBS	47	44	42	-2	-5
U.S. Non-Agency CMBS	93	89	87	-2	-6
Asset-Backed Securities	59	45	41	-4	-18
Corporate Sectors					
U.S. Investment Grade	123	102	110	8	-13
Industrial	125	106	116	10	-9
Utility	117	101	105	4	-12
Financial Institutions	120	96	101	5	-19
U.S. High Yield	409	352	378	26	-31

Source: Bloomberg Barclays Indices

Total Returns of Selected Bloomberg Barclays Indices and Subsectors

Bloomberg Barclays Index/Sector	August	YTD
U.S. Aggregate Index	0.90%	3.64%
U.S. Gov't/Credit Index	0.96%	4.08%
U.S. Intermediate Gov't/Credit Index	0.59%	2.81%
U.S. 1-3 Yr. Gov't/Credit Index	0.20%	1.18%
U.S. Treasury	1.08%	3.15%
U.S. Agency	0.63%	2.56%
MBS (Mortgage-Backed Securities)	0.73%	2.55%
CMBS (Commercial Mortgage-Backed Securities)	1.13%	3.98%
ABS (Asset-Backed Securities)	0.38%	1.80%
U.S. Corporate - Investment Grade	0.78%	5.37%
Corporate High Yield	-0.04%	6.05%
Municipal Bond Index	0.76%	5.20%
TIPS (Treasury Inflation Protected Securities)	1.06%	2.38%

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.