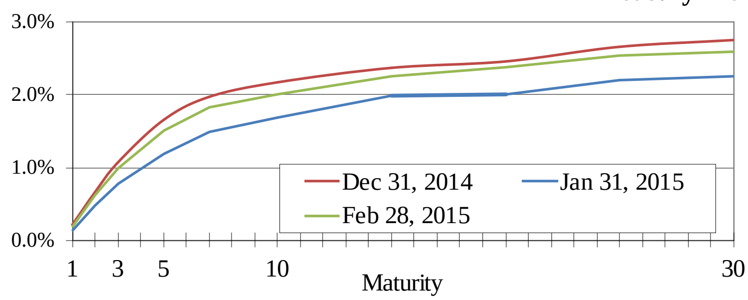
Baird Advisors
Fixed Income Market Comments
February 2015

Yields Rise in February, Reversing Much of January Drop

The yield on the 10-year Treasury rose 32 bps to 2.00% and the yield curve steepened in February, reversing much of the prior month's decline as U.S. jobs data came in stronger than expected (Jan. nonfarm payrolls +257K vs +228K consensus forecast with an additional +147K revision to the prior two months). The Fed meeting minutes confirmed that the central bank is prepared to begin raising the Fed funds rate, but uncertainty remains high with regard to the timing of an initial Fed move and the magnitude of subsequent policy tightening. As the U.S. economy comes closer to prescribed employment and expected inflation targets, the Fed has advised that its guidance will become less definitive and policy moves will continue to be "data dependent." As such, interest rate volatility could remain high as the market anticipates the Fed's next move.

Treasury Yields



Maturity	Dec 31, 2014	Jan 31, 2015	Feb 28, 2015	1Mo Change
1	0.21%	0.14%	0.19%	0.05%
2	0.66%	0.47%	0.62%	0.15%
3	1.07%	0.77%	1.00%	0.23%
5	1.65%	1.19%	1.50%	0.31%
7	1.97%	1.49%	1.82%	0.33%
10	2.17%	1.68%	2.00%	0.32%
30	2.75%	2.25%	2.60%	0.35%

Spreads Tighten Significantly

Spreads tightened significantly in February as Greece negotiated a temporary bailout extension, oil prices stabilized, and spread sectors were attractive relative to extremely low (and often negative) yields on global sovereign bonds. Stability in oil prices during the month following the precipitous drop from October through January eased fundamental credit concerns in the energy sector, which contributed to a 78 bps tightening in corporate high yield spreads. Investment grade corporate spreads also tightened 13 bps this month on strong investor demand and continued solid credit fundamentals. Asset-backed spreads were unchanged in the month and wider for the year as robust new issuance pushed spreads wider.

Option-Adjusted Spreads (in bps)

	12/31/14	1/31/15	2/28/15	1Mo Change	YTD Change
U.S. Aggregate Index	48	51	43	-8	-5
U.S. Agency (non-mortgage)	16	18	16	-2	0
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	27	33	18	-15	-9
Asset-Backed Securities	58	63	63	0	5
CMBS: Non-Agency	118	127	114	-13	-4
Corporate Sectors					
U.S. Investment Grade	131	136	123	-13	-8
Industrial	140	146	130	-16	-10
Utility	119	121	112	-9	-7
Financial Institutions	117	123	112	-11	-5
U.S. High Yield	483	509	431	-78	-52

Source: Barclays

Rising Yields Lead to Negative Returns, Except High Yield

Rising yields led to negative returns for all investment grade sectors in February while the tightening of spreads enabled spread sectors to outperform Treasuries (-1.54%) which had the weakest returns. Investment Grade Corporates (-1.01%) fared somewhat better as spreads tightened and sectors with shorter average maturities (e.g. ABS -0.38%) posted some of the smallest declines. Mortgage-Backed Securities (-0.16%) offered relatively stable returns as rising mortgage rates reduced the imminent risk of prepayments on premium priced securities. High Yield returns (+2.41%) stood out as the only sector with positive returns this month, maintaining a strong correlation with upward moves in the equity market.

Total Returns of Selected Barclays Indices and Subsectors

Barclays Index/Sector	February	YTD
U.S. Aggregate Index	-0.94%	1.14%
U.S. Gov't/Credit Index	-1.27%	1.33%
U.S. Intermediate Gov't/Credit Index	-0.70%	0.95%
U.S. 1-3 Yr. Gov't/Credit Index	-0.16%	0.36%
U.S. Treasury	-1.54%	1.00%
U.S. Agency	-0.79%	0.74%
MBS (Mortgage-Backed Securities)	-0.16%	0.68%
CMBS (Commercial Mortgage-Backed Securities)	-0.64%	1.13%
ABS (Asset-Backed Securities)	-0.38%	0.48%
U.S. Corporate - Investment Grade	-1.01%	1.99%
Corporate High Yield	2.41%	3.09%
Municipal Bond Index	-1.03%	0.72%
TIPS (Treasury Inflation Protected Securities)	-1.20%	1.91%

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.