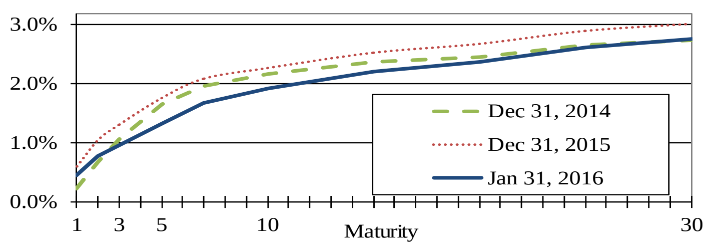
Baird Advisors
Fixed Income Market Comments
January 2016

Treasury Yields Fall Amidst Continued Volatility

The yield on the 5-year Treasury fell 43 bps to 1.33% leading all yields along the yield curve lower as expectations for additional Fed Funds rate hikes diminished in light of mixed economic data and volatile global markets. Economic data painted a mixed picture to start the year. While overall domestic growth slowed modestly (4Q annualized GDP +0.7%, down from +2.0% in 3Q), the labor market continued to show solid progress (Dec. nonfarm payrolls +292k vs 200k consensus). U.S equity markets fell more than 10% to start the year on weak growth concerns as oil prices fell below $30 a barrel for the first time since 2003. As expected, the Fed did not change its 0.25% to 0.50% Fed Funds target at its Jan. 27 meeting but added dovish language to its statement about monitoring "global economic and financial developments" which suggests they may be cautious about making additional rate hikes over the next several months. The Fed's statement of economic projections from December 2015 projected four hikes totaling 100bps in 2016, but the market is now pricing in just one 25 bp hike or less in 2016.

Treasury Yields



Maturity	12/31/14	12/31/15	1/31/16	1Mo Chg
1	0.22%	0.60%	0.45%	-0.15%
2	0.67%	1.05%	0.77%	-0.28%
3	1.07%	1.31%	0.97%	-0.34%
5	1.65%	1.76%	1.33%	-0.43%
7	1.97%	2.09%	1.67%	-0.42%
10	2.17%	2.27%	1.93%	-0.34%
30	2.75%	3.02%	2.76%	-0.26%

Corporate Spreads Widen, Negative Global Bond Yields Persist

Corporate yield spreads widened in January as investors sought the liquidity and safety of Treasuries, agency-guaranteed securities, and short asset-backed securities (ABS). Investment grade spreads widened 28 bps to 193 bps this month and high yield spreads gapped 74 bps wider to 734 bps. Corporate issuance of $128B in the month eclipsed January 2013 ($115B) as the busiest January on record. Issuance activity was led by AB Inbev, which issued $46B in the second largest corporate debt deal of all time to fund its acquisition of SABMiller. Strong investor demand and extremely accommodative global central bank policies have pushed government bond yields negative on 25% of the JP Morgan global government bond index. This month the bank of Japan followed in the footsteps of the ECB and adopted a negative interest rate policy, cutting interest on excess reserves to -10 bps.

Option-Adjusted Spreads (in bps)

	12/31/14	12/31/15	1/31/16	1Mo Chg
U.S. Aggregate Index	48	56	63	7
U.S. Agency (non-mortgage)	16	21	18	-3
Mortgage and ABS Sectors				
U.S. Agency Pass-throughs	27	24	21	-3
Asset-Backed Securities	58	72	66	-6
CMBS	98	121	132	11
Corporate Sectors				
U.S. Investment Grade	131	165	193	28
Industrial	140	183	216	33
Utility	119	150	160	10
Financial Institutions	117	134	157	23
U.S. High Yield	483	660	734	74

Source: Barclays

Falling Yields Boost Returns, Spread Sectors Lag

Declining yields contributed to strong returns in January as all investment grade sectors posted positive returns. Treasuries posted the strongest sector returns (+2.13%), investment grade corporates (+0.35%) managed to post positive returns in spite of wider spreads and heavy issuance, but corporate high yield (-1.61%) dropped in a more correlated move with lower equity markets.

Total Returns of Selected Barclays Indices and Subsectors

Barclays Index/Sector	January	4Q 2015	2015
U.S. Aggregate Index	1.38%	-0.57%	0.55%
U.S. Gov't/Credit Index	1.41%	-0.74%	0.15%
U.S. Intermediate Gov't/Credit Index	1.22%	-0.69%	1.07%
U.S. 1-3 Yr. Gov't/Credit Index	0.52%	-0.36%	0.65%
U.S. Treasury	2.13%	-0.94%	0.84%
U.S. Agency	1.38%	-0.64%	1.01%
MBS (Mortgage-Backed Securities)	1.30%	-0.10%	1.51%
CMBS (Commercial Mortgage-Backed Securities)	1.51%	-1.24%	0.97%
ABS (Asset-Backed Securities)	1.02%	-0.57%	1.25%
U.S. Corporate - Investment Grade	0.35%	-0.58%	-0.68%
Corporate High Yield	-1.61%	-2.07%	-4.47%
Municipal Bond Index	1.19%	1.50%	3.30%
TIPS (Treasury Inflation Protected Securities)	1.48%	-0.64%	-1.44%

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.