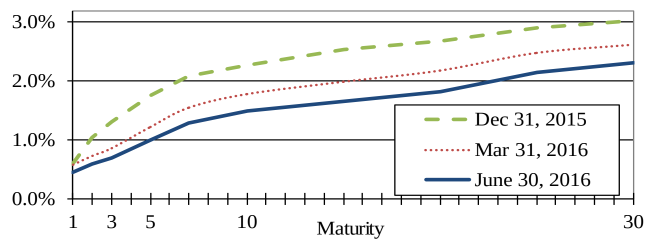
Baird Advisors
Fixed Income Market Comments
June 2016

Brexit Vote Surprises Markets, Fed Lowers Growth/Rate Hike Expectations, Yields Fall

Treasury yields fell sharply in June as Britain unexpectedly voted to leave the European Union ("Brexit") and U.S. economic data disappointed, causing the Fed to lower expectations for future rate hikes. The 10 year Treasury yield fell 34 bps in the month to end the quarter at 1.49%, down 78 bps YTD and approaching all-time lows. European equities fell on the Brexit news and the British Pound hit a 30+ year low. The long-term impacts of this historic vote remain to be seen, but it is reasonable to expect modestly slower global growth and higher volatility, creating additional challenges for global central banks. Prior to Brexit, the Fed lowered its growth forecast and projected timing of Fed Funds rate hikes following a much weaker-than-expected +38K May payroll report. Markets now expect the Fed to wait until 2017 or beyond before hiking rates as tepid growth and minimal inflation persist. This comes as a major shift from April and May when Chair Yellen and the Fed publicly discussed how a Fed Funds rate hike could be warranted "in the coming months," and the market had priced a more than 50% chance of a rate hike in July.



Treasury Yields

Maturity	12/31/15	3/31/16	5/31/16	6/30/16	1Mo Chg	3Mo Chg	YTD Chg
1	0.60%	0.58%	0.68%	0.44%	-0.24%	-0.14%	-0.16%
2	1.05%	0.73%	0.87%	0.59%	-0.28%	-0.14%	-0.46%
3	1.31%	0.86%	1.02%	0.70%	-0.32%	-0.16%	-0.61%
5	1.76%	1.22%	1.36%	1.01%	-0.35%	-0.21%	-0.75%
7	2.09%	1.55%	1.65%	1.29%	-0.36%	-0.26%	-0.80%
10	2.27%	1.78%	1.83%	1.49%	-0.34%	-0.29%	-0.78%
30	3.02%	2.62%	2.63%	2.31%	-0.32%	-0.31%	-0.71%

Q2 Spreads Tighter Despite Brexit, More Negative Yields

Despite Brexit-induced yield spread widening in June, spreads ended the quarter tighter as global demand for U.S. assets intensified. The remarkably low yield environment abroad continues to stoke demand for positive-yielding U.S. dollar-denominated assets. More than $11.8 trillion of bonds in the BofA Global Broad Market Index now have negative or zero yields. For example, the German 10 year sovereign bond traded at a negative yield for the first time ever driven by strong demand for safe haven assets. In addition, the European Central Bank began its €5 billion per month bond buying program, purchasing non-financial, Euro-denominated corporate bonds. In June Toyota issued ¥20B of 3 year bonds in Japan at a yield of 0.001% - making it the lowest yielding new issue corporate ever.

Option-Adjusted Spreads (in bps)

	12/31/15	3/31/16	5/31/16	6/30/16	1Mo Chg	3Mo Chg	YTD Chg
U.S. Aggregate Index	56	56	51	55	4	-1	-1
U.S. Agency (non-mortgage)	21	20	19	21	2	1	0
Mortgage and ABS Sectors							
U.S. Agency Pass-throughs	24	22	18	27	9	5	3
Asset-Backed Securities	72	74	60	61	1	-13	-11
CMBS	121	109	94	98	4	-11	-23
Corporate Sectors							
U.S. Investment Grade	165	163	149	156	7	-7	-9
Industrial	183	168	155	159	4	-9	-24
Utility	150	151	133	142	9	-9	-8
Financial Institutions	134	155	141	152	11	-3	18
U.S. High Yield	660	656	566	594	28	-62	-66

Sources: Barclays

Falling Yields Generate Strong Quarterly, YTD Returns

The decline in Treasury yields boosted returns across all sectors, with longer maturities generating the strongest absolute returns for June and Q2. Corporates had the strongest performance of investment grade sectors for the quarter (+3.57%), while high yield led the pack (+5.52%) as markets made a profound recovery from the turmoil of the first quarter. High quality sectors with stable cash flows, such as commercial mortgage backed securities (+2.24%) outperformed, while agency mortgage-backed securities lagged for the quarter (+1.11%) on heightened prepayment risks. The impressive year-to-date returns across bond markets show a heightened global demand for low-risk investments coupled with a limited supply of positive yielding assets.

Total Returns of Selected Barclays Indices and Subsectors

Barclays Index/Sector	June	3 Mo	YTD
U.S. Aggregate Index	1.80%	2.21%	5.31%
U.S. Gov't/Credit Index	2.20%	2.67%	6.23%
U.S. Intermediate Gov't/Credit Index	1.43%	1.59%	4.07%
U.S. 1-3 Yr. Gov't/Credit Index	0.60%	0.67%	1.65%
U.S. Treasury	2.21%	2.10%	5.37%
U.S. Agency	1.19%	1.22%	3.28%
MBS (Mortgage-Backed Securities)	0.81%	1.11%	3.10%
CMBS (Commercial Mortgage-Backed Securities)	1.72%	2.24%	5.92%
ABS (Asset-Backed Securities)	0.83%	1.17%	2.54%
U.S. Corporate - Investment Grade	2.25%	3.57%	7.68%
Corporate High Yield	0.92%	5.52%	9.06%
Municipal Bond Index	1.59%	2.61%	4.33%
TIPS (Treasury Inflation Protected Securities)	2.08%	1.71%	6.24%

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.