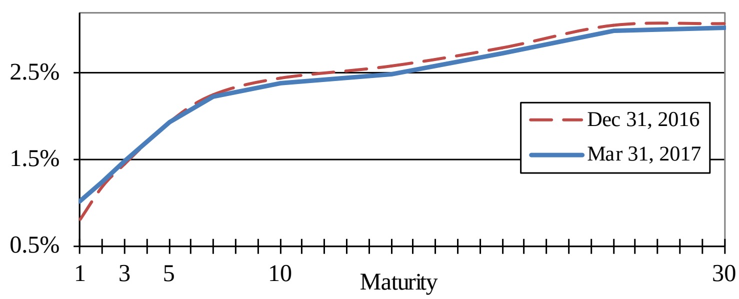
Baird Advisors
Fixed Income Market Comments
March 2017

Stable Yields Amid Political Uncertainty

Short term Treasury yields rose in the quarter as the Fed hiked the Fed Fund's rate 25 bps at its March meeting and the curve flattened on strong demand for longer duration assets. The 10yr Treasury traded in a 29 bps range, ending the quarter 5 bps lower at 2.39% despite expectations by many that yields would continue to move higher in 2017. At the start of the year, both consumer and business confidence surveys showed heightened expectations that growth (and inflation) would rise, spurred on by an aggressive, pro-growth fiscal agenda from Washington. The new administration started with executive orders targeting issues such as regulation and immigration and then, working with the House GOP leaders, turned to healthcare reform, which ultimately fell short. Witnessing the challenges in passing a healthcare reform bill, market expectations for tax reform fell, with any changes now likely to be slower in coming and less impactful than previously believed. At the same time, many economists are forecasting that 1Q17 growth slowed modestly from the +2.1% annualized pace in 4Q16. Despite disappointment on the fiscal front, markets are pricing a more than 50% probability of two additional 25 bps Fed Funds rate hikes in 2017. Around the globe, political uncertainty has abated somewhat - while far-right candidates lost ground in polls to more traditional candidates in upcoming French elections, Britain officially triggered Article 50, starting an unprecedented two-year process to separate from the EU. Global deflation fears have eased thanks to modest improvement in growth in most regions; however, the range of possible outcomes remains wide.

Treasury Yields



Maturity	12/31/16	2/28/17	3/31/17	1Mo Chg	YTD Chg
1	0.81%	0.79%	1.02%	0.23%	0.21%
2	1.19%	1.21%	1.25%	0.04%	0.06%
3	1.45%	1.47%	1.49%	0.02%	0.04%
5	1.93%	1.88%	1.93%	0.05%	0.00%
7	2.25%	2.18%	2.22%	0.04%	-0.03%
10	2.44%	2.36%	2.39%	0.03%	-0.05%
30	3.07%	2.97%	3.02%	0.05%	-0.05%

Credit and ABS Tighten in Q1, Agency Pass-throughs Widen

Both Corporate Credit and ABS tightened modestly in the quarter as fundamentals remained solid and strong investor demand was visible in heightened mutual fund and ETF inflows. The Fed's discussion of the eventual end of reinvestment in agency mortgage-backed securities contributed to a 12 bps spread widening in the sector. The Fed purchased more than $86B of MBS this quarter, helping to keep spreads at historically tight levels as they continue to own almost 1/3 of this sector.

Positive Returns, Corporates Outperform

All major sectors posted positive returns for the quarter. Investment-grade corporates (+1.22%) and CMBS (+0.86%) were investment-grade categories that benefitted from robust demand. Municipal Bonds (+1.58%) benefitted as expectations for major tax reform fell. High yield corporates (+2.70%) had the strongest overall returns as the sector exhibited a strong correlation with rising equity markets.

Option-Adjusted Spreads (in bps)

	12/31/16	2/28/17	3/31/17	1Mo Chg	YTD Chg
U.S. Aggregate Index	43	43	44	1	1
U.S. Agency (non-mortgage)	21	16	18	2	-3
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	15	22	27	5	12
Asset-Backed Securities	59	59	54	-5	-5
CMBS	75	75	77	2	2
Corporate Sectors					
U.S. Investment Grade	123	115	118	3	-5
Industrial	125	118	121	3	-4
Utility	117	112	116	4	-1
Financial Institutions	120	111	113	2	-7
U.S. High Yield	409	363	383	20	-26

Sources: Bloomberg Barclays Indices

Total Returns of Selected Bloomberg Barclays Indices and Subsectors

Bloomberg Barclays Index/Sector	March	YTD	2016
U.S. Aggregate Index	-0.05%	0.82%	2.65%
U.S. Gov't/Credit Index	-0.09%	0.96%	3.05%
U.S. Intermediate Gov't/Credit Index	0.05%	0.78%	2.08%
U.S. 1-3 Yr. Gov't/Credit Index	0.05%	0.41%	1.28%
U.S. Treasury	-0.05%	0.67%	1.04%
U.S. Agency	0.08%	0.76%	1.39%
MBS (Mortgage-Backed Securities)	0.03%	0.47%	1.67%
CMBS (Commercial Mortgage-Backed Securities)	0.03%	0.86%	3.32%
ABS (Asset-Backed Securities)	0.18%	0.54%	2.03%
U.S. Corporate - Investment Grade	-0.23%	1.22%	6.11%
Corporate High Yield	-0.22%	2.70%	17.13%
Municipal Bond Index	0.22%	1.58%	0.25%
TIPS (Treasury Inflation Protected Securities)	-0.05%	1.26%	4.68%

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.