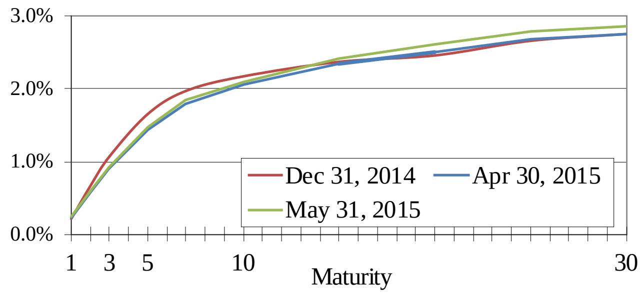
Baird Advisors
Fixed Income Market Comments
May 2015

Yields Rise and Curve Steepens

The yield on the 30yr Treasury bond rose 10 bps to 2.85% this month and the curve steepened as global bond yields rose and U.S. economic activity showed some signs of reacceleration. U.S. employment bounced back from a weak prior month (April nonfarm payrolls +223K vs. +85K in March) and housing activity was stronger than expected (April housing starts +1,135K vs. 1,015K market expectation). Fed Chair Yellen remarked in a speech this month that if the economy moves in line with Fed forecasts, she expects an initial Fed funds rate increase later this year, and that delaying the first increase until employment and inflation meet the Fed's objectives "would risk overheating the economy." While the Fed may commence rate increases this year, both the Fed and markets are projecting a very gradual pace of subsequent increases.

Treasury Yields



Maturity	Dec 31, 2014	Apr 30, 2015	May 31, 2015	1Mo Change	YTD Change
1	0.21%	0.23%	0.24%	0.01%	0.03%
2	0.66%	0.58%	0.60%	0.02%	-0.06%
3	1.07%	0.91%	0.92%	0.01%	-0.15%
5	1.65%	1.44%	1.47%	0.03%	-0.18%
7	1.97%	1.80%	1.84%	0.04%	-0.13%
10	2.17%	2.05%	2.09%	0.04%	-0.08%
30	2.75%	2.75%	2.85%	0.10%	0.10%

Spreads Widen on Record Corporate Issuance

Yield spreads widened modestly on Investment Grade Corporates (+5 bps, see table at right) as monthly gross issuance of $155B set an all-time record. Corporations brought a number of large deals to the market as Apple, Qualcomm, and Royal Dutch Shell all issued $10B each, and AbbVie and Siemens raised $16.7B and $7.75B respectively to fund acquisitions. In contrast, High Yield Corporate issuance slowed, oil prices remained stable, and robust investor demand drove spreads 6 bps tighter, making it the only sector to tighten significantly. Meanwhile, structured product spreads were nearly unchanged this month as fundamentals and supply/demand technicals were relatively stable.

Option-Adjusted Spreads (in bps)

	12/31/14	4/30/15	5/31/15	1Mo Change	YTD Change
U.S. Aggregate Index	48	44	46	2	-2
U.S. Agency (non-mortgage)	16	16	16	0	0
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	27	16	18	2	-9
Asset-Backed Securities	58	61	60	-1	2
CMBS	98	93	94	1	-4
Corporate Sectors					
U.S. Investment Grade	131	128	133	5	2
Industrial	140	135	141	6	1
Utility	119	120	129	9	10
Financial Institutions	117	118	119	1	2
U.S. High Yield	483	439	433	-6	-50

Source: Barclays

Rising Yields Lead to Mixed Returns

Rising yields led to flat or negative returns in many bond sectors, except for Corporate High Yield (+0.30%) and Asset-Backed Securities (ABS +0.15%) that benefitted from modest spread tightening. Investment Grade Corporates (-0.65%) trailed the pack due to the heavy supply and TIPS (-0.82%) dropped the most, giving back much of the prior month's strong performance.

Total Returns of Selected Barclays Indices and Subsectors

Barclays Index/Sector	May	YTD
U.S. Aggregate Index	-0.24%	1.00%
U.S. Gov't/Credit Index	-0.34%	0.95%
U.S. Intermediate Gov't/Credit Index	0.01%	1.42%
U.S. 1-3 Yr. Gov't/Credit Index	0.08%	0.75%
U.S. Treasury	-0.18%	0.92%
U.S. Agency	0.03%	1.04%
MBS (Mortgage-Backed Securities)	-0.02%	1.08%
CMBS (Commercial Mortgage-Backed Securities)	0.04%	1.73%
ABS (Asset-Backed Securities)	0.15%	1.14%
U.S. Corporate - Investment Grade	-0.65%	0.94%
Corporate High Yield	0.30%	4.07%
Municipal Bond Index	-0.28%	0.21%
TIPS (Treasury Inflation Protected Securities)	-0.82%	1.33%

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.