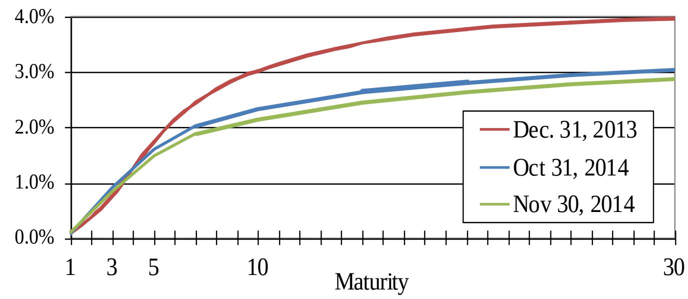
Baird Advisors
Fixed Income Market Comments
November 2014

Yields Fall, Curve Flattens

Treasury yields fell and the yield curve flattened modestly (see chart and table below) in November as declining energy prices and economic weakness outside the US put downward pressure on inflation expectations. The European Central Bank indicated its inclination to initiate Eurozone QE in order to ward off deflation and spur growth. Japan also remained committed to its ultra-accommodative posture following the expansion of their QE program on October 31st. In contrast, the Fed confirmed that it still sees the current pace of domestic growth as sufficient to warrant raising the Fed funds rate sometime in 2015. This divergence in central bank policies has affected global capital flows this year with US markets (and the US$) being the major beneficiaries.

Treasury Yields



Maturity	Dec 31, 2013	Oct 31, 2014	Nov 30, 2014	1Mo Change	YTD Change
1	0.11%	0.09%	0.12%	0.03%	0.01%
2	0.38%	0.49%	0.47%	-0.02%	0.09%
3	0.77%	0.92%	0.85%	-0.07%	0.08%
5	1.74%	1.61%	1.48%	-0.13%	-0.26%
7	2.45%	2.04%	1.88%	-0.16%	-0.57%
10	3.03%	2.33%	2.16%	-0.17%	-0.87%
30	3.97%	3.06%	2.89%	-0.17%	-1.08%

Corporate Yield Spreads Widen on Heavy Supply

Gross issuance of investment grade corporate bonds totaled over $100 billion for the month of November, bringing the year-to-date total to $948 billion, the largest number on record (see table at right). The combination of heavy supply and fears of weaker global growth caused yield spreads on investment grade corporates to widen 6 bps in November (from 118 to 124 bps), with longer bonds feeling the impact more sharply than short and intermediate maturities. Yield spreads on securitized sectors (e.g. MBS) were virtually unchanged on the month as supply was more manageable and demand remained strong.

Gross Investment Grade Supply
(largest through 11-mos)

Year	Supply ($Bln)
2014	948
2009	934
2013	883
2012	882

Source: JP Morgan

Strong Returns, Except for High Yield

The decline in yields overshadowed the modest widening of spreads and all investment grade sectors enjoyed strong returns in November, led by Treasuries (+0.81%). Corporates (+0.63%) endured heavy issuance while MBS (+0.65%) and CMBS (+0.67%) benefited from more favorable supply/demand dynamics. Municipals also managed a positive return (+0.17%) despite an uptick in supply, but High Yield faltered (-0.73%) as demand was insufficient to absorb the increased supply, particularly in the energy sector (which comprises 15% of the HY sector) where lower energy prices raised additional credit concerns on the part of investors.

Total Returns of Selected Barclays Indices and Subsectors

Barclays Index/Sector	November	YTD
U.S. Aggregate Index	0.70%	5.86%
U.S. Gov't/Credit Index	0.72%	5.91%
U.S. Intermediate Gov't/Credit Index	0.50%	3.45%
U.S. 1-3 Yr. Gov't/Credit Index	0.15%	1.03%
U.S. Treasury	0.81%	4.91%
U.S. Agency	0.51%	3.57%
MBS (Mortgage Backed Securities)	0.65%	5.92%
CMBS (Commercial Mortgage Backed Securities)	0.67%	4.02%
ABS (Asset Backed Securities)	0.25%	2.10%
U.S. Corporate - Investment Grade	0.63%	7.35%
Corporate High Yield	-0.73%	3.96%
Municipal Bond Index	0.17%	8.50%
TIPS (Treasury Inflation Protected Securities)	0.26%	4.82%

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.