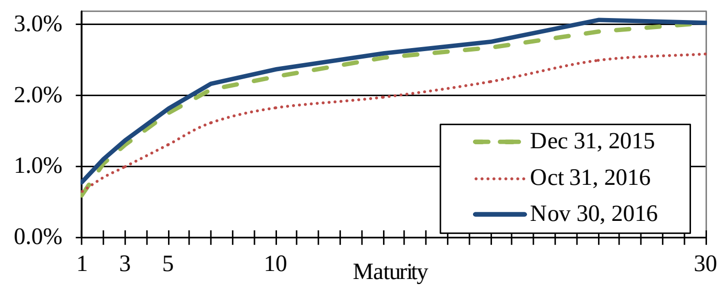
Baird Advisors
Fixed Income Market Comments
November 2016

Yields Rise on Election Surprise

U.S. Treasury yields rose sharply after a U.S. election surprise in which the Republican Party held onto the majority of seats in the House and Senate and Trump defied polls and market expectations by winning the presidency. Markets quickly reacted to the surprise result – the U.S. 10-year Treasury yield rose 54 bps for the month to 2.37% - as markets repositioned in anticipation of potential fiscal stimulus and tax cuts to spur growth. U.S. economic data continued to confirm solid progress (October nonfarm payrolls +161K) and the Fed's November meeting statement continued to guide the market to a December fed funds rate hike – market implied odds of a December rate hike rose all the way to 100% which seldom occurs.

Treasury Yields



Maturity	12/31/15	9/30/16	10/31/16	11/30/16	1Mo Chg	YTD Chg
1	0.60%	0.58%	0.65%	0.77%	0.12%	0.17%
2	1.05%	0.76%	0.85%	1.11%	0.26%	0.06%
3	1.31%	0.87%	1.00%	1.38%	0.38%	0.07%
5	1.76%	1.15%	1.31%	1.83%	0.52%	0.07%
7	2.09%	1.43%	1.62%	2.17%	0.55%	0.08%
10	2.27%	1.60%	1.83%	2.37%	0.54%	0.10%
30	3.02%	2.33%	2.59%	3.02%	0.43%	0.00%

Credit, CMBS Spreads Tighten Further

In spite of heightened interest rate volatility, investment grade credit spreads tightened 3 bps as steady demand for credit offset modestly negative industry fund flows. In securitized sectors, CMBS tightened 15 bps this month as higher yields attracted additional investors and net supply remained negative year to date. Market expectations for pro-growth, business-friendly policies including lower corporate tax rates and the pullback of various regulations (e.g. Dodd-Frank) also contributed to spread tightening. However, investors continue to grapple with a wide range of possible policy outcomes which may keep market volatility elevated.

Option-Adjusted Spreads (in bps)

	12/31/15	10/31/16	11/30/16	1Mo Chg	YTD Chg
U.S. Aggregate Index	56	45	45	0	-11
U.S. Agency (non-mortgage)	21	20	18	-2	-3
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	24	13	16	3	-8
Asset-Backed Securities	72	53	50	-3	-22
CMBS	121	82	67	-15	-54
Corporate Sectors					
U.S. Investment Grade	165	132	129	-3	-36
Industrial	183	135	132	-3	-51
Utility	150	125	122	-3	-28
Financial Institutions	134	129	124	-5	-10
U.S. High Yield	660	477	455	-22	-205

Sources: Bloomberg Barclays Indices

Negative November Returns, Mixed YTD Returns

Yields rose sharply on the election results pushing returns negative across all bond sectors for the month. November marks the fourth consecutive month of negative returns for the Bloomberg Barclays Aggregate Index. YTD returns for the Aggregate Index, which exceeded 6.00% as recently as late-September, ended November at 2.50%. Corporate High Yield held up well in the month (-0.47%) due to strong demand, and delivered equity-like returns so far this year (15.01% YTD). Municipals had the weakest returns for both the month and year as industry fund flows turned negative as the prospect of tax reform (lower marginal tax rates) potentially lessens the appeal of tax-exempt income.

Total Returns of Selected Bloomberg Barclays Indices and Subsectors

Bloomberg Barclays Index/Sector	November	YTD
U.S. Aggregate Index	-2.37%	2.50%
U.S. Gov't/Credit Index	-2.65%	2.83%
U.S. Intermediate Gov't/Credit Index	-1.73%	2.01%
U.S. 1-3 Yr. Gov't/Credit Index	-0.41%	1.22%
U.S. Treasury	-2.67%	1.14%
U.S. Agency	-1.39%	1.52%
MBS (Mortgage-Backed Securities)	-1.71%	1.67%
CMBS (Commercial Mortgage-Backed Securities)	-1.86%	3.74%
ABS (Asset-Backed Securities)	-0.52%	2.18%
U.S. Corporate - Investment Grade	-2.68%	5.41%
Corporate High Yield	-0.47%	15.01%
Municipal Bond Index	-3.73%	-0.92%
TIPS (Treasury Inflation Protected Securities)	-1.92%	4.79%

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.