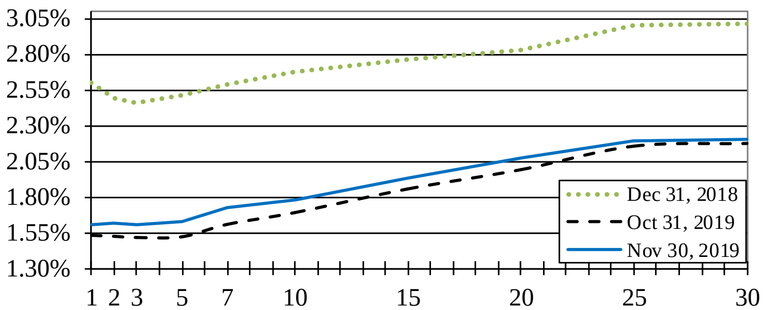
Baird Advisors
Fixed Income Market Commentary
November 2019

Elevated Rate Volatility Persists, China Trade Optimism Fades During Month, U.S. Labor Market Remains Strong

Elevated interest rate volatility continued in November as the benchmark 10yr Treasury yield rose 0.25%, from 1.69% to 1.94% early in the month, before settling back to 1.78% at month-end. The curve steepened from the short end to the 7yr maturity and flattened from the 7yr to the 30yr range. The move higher in yields at the beginning of the month was global in nature as benchmark government bonds such as the French 10yr rose back into positive territory after being as low as -0.40% in early September. Optimism on U.S./China trade talks helped spark the yield rise, after an announcement in late October that the U.S. and China were close to signing a preliminary trade agreement by month-end. However, the negotiations appeared to stall again towards the end of the month, as President Trump signed the Human Rights and Democracy Act in support of Hong Kong protesters, ignoring China's warnings. The rise in yields was also aided by better U.S. labor market data as October nonfarm payrolls expanded 128,000 and were revised higher by 40,000 jobs for September, beating market expectations. On the U.S. political front, the impeachment hearings of President Trump ended in the House Intelligence Committee and move next to the Judiciary Committee. Finally, the third UK general election in four years is scheduled for December 12, with implications for the timing and scope of Brexit.

Treasury Yields



Maturity	12/31/18	10/31/19	11/30/19	1Mo Chg	YTD
1	2.60%	1.53%	1.60%	0.07%	-1.00%
2	2.49%	1.52%	1.62%	0.10%	-0.87%
3	2.46%	1.52%	1.61%	0.09%	-0.85%
5	2.51%	1.52%	1.63%	0.11%	-0.88%
7	2.59%	1.61%	1.73%	0.12%	-0.86%
10	2.68%	1.69%	1.78%	0.09%	-0.90%
30	3.02%	2.18%	2.21%	0.03%	-0.81%

Corporate Spreads Continue Tightening Trend

Investment Grade Corporate spreads continued their tightening trend this month - another 5 bps tighter to end November at 105 bps (-48bps YTD). Spreads tightened on better than expected (although still down) corporate earnings reports as flows into fixed income, both taxable and tax-exempt, remained on pace for a record-setting year. Total net flows into all fixed income mutual funds and ETFs have reached nearly $400B YTD according to ICI. Mortgage and Asset-Backed securities tightened modestly with the exception of Non-Agency CMBS, which ended the month 3 bps wider at 85 bps, giving back some of its strong YTD tightening (-22 bps). In spite of moderating net flows in High Yield, the sector snapped back 22 bps tighter to 370 bps after widening the previous month.

Mixed Returns in November, Strong YTD Returns

Sector returns were mixed in November as rising rates detracted from returns while tightening spreads benefitted most spread sectors. Spread sectors finished ahead of Treasuries (-0.30%) with the exception of CMBS (-0.41%), while High Yield Corporates (+0.33%) posted the highest overall returns, followed closely by Investment Grade Corporates and Municipals (+0.25%).

Option-Adjusted Spreads (in bps)

	12/31/18	10/31/19	11/30/19	1Mo Chg	YTD Chg
U.S. Aggregate Index	54	46	44	-2	-10
U.S. Agency (non-mortgage)	16	12	9	-3	-7
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	35	49	45	-4	10
U.S. Agency CMBS	55	52	49	-3	-6
U.S. Non-Agency CMBS	107	82	85	3	-22
Asset-Backed Securities	53	41	38	-3	-15
Corporate Sectors					
U.S. Investment Grade	153	110	105	-5	-48
Industrial	157	117	111	-6	-46
Utility	144	108	105	-3	-39
Financial Institutions	147	98	91	-7	-56
Other Govt. Related	90	78	76	-2	-14
U.S. High Yield Corporates	526	392	370	-22	-156
Emerging Market Debt	560	617	626	9	66

Source: Bloomberg Barclays Indices

Total Returns of Selected Bloomberg Barclays Indices and Subsectors

	November	YTD	Effective Duration (years)
U.S. Aggregate Index	-0.05%	8.79%	5.88
U.S. Gov't/Credit Index	-0.09%	9.93%	7.00
U.S. Intermediate Gov't/Credit Index	-0.15%	6.67%	3.93
U.S. 1-3 Yr. Gov't/Credit Index	0.00%	3.78%	1.89
U.S. Treasury	-0.30%	7.46%	6.58
U.S. Agency (Non-Mortgage)	-0.07%	6.11%	4.12
U.S. Agency Pass-Throughs	0.08%	6.06%	3.05
CMBS (Commercial Mortgage Backed Securities)	-0.41%	8.56%	5.25
ABS (Asset-Backed Securities)	0.01%	4.42%	2.17
U.S. Corporate Investment Grade	0.25%	14.17%	7.91
U.S. High Yield Corporates	0.33%	12.08%	3.10
Emerging Market Debt	-0.19%	7.68%	4.62
Municipal Bond Index	0.25%	7.21%	5.30
TIPS (Treasury Inflation Protected Securities)	0.15%	8.02%	4.54

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.

Emerging Market: Bloomberg uses a fixed list of countries defined as emerging markets countries for index inclusion purposes that is based on World Bank Income group definitions (Low/Middle), IMF country classifications (Non-Advanced Economies), and other advanced economies that may be less accessible or investable for global debt investors.

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.