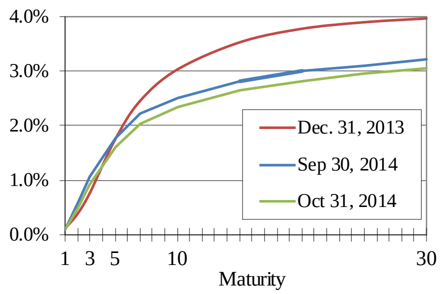
Baird Advisors
Fixed Income Market Comments
October 2014

Volatility Increases and Yields Fall Further

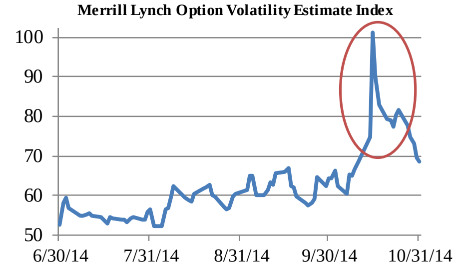
The yield on the 10-year Treasury ended October 18 bps lower at 2.33% after ranging from 2.51% to 1.86% during the month. Interest rate volatility picked up significantly by mid-month (see MOVE volatility chart below right), driven by concerns over continued economic weakness outside the U.S., especially the Eurozone, and the sharp drop in both global equity and commodity markets. Uncertainty over the Fed's exit plan – now shifting from the end of QE to the first hike in rates some time in 2015 - also contributed to the increase in volatility. Market expectations for the first rate hike by the Fed have shifted from mid-year 2015 to 3Q 2015 given continued weak growth outside the U.S. and the recent turmoil in the global equity and commodity markets.

Treasury Yields



Maturity	Sep 30, 2014	Oct 31, 2014	1Mo Change
1	0.10%	0.09%	-0.01%
2	0.58%	0.49%	-0.09%
3	1.05%	0.92%	-0.13%
5	1.78%	1.61%	-0.17%
7	2.22%	2.04%	-0.18%
10	2.51%	2.33%	-0.18%
30	3.21%	3.06%	-0.15%

Interest Rate Volatility - MOVE Index
Merrill Lynch Option Volatility Estimate Index



Yield Spreads Mixed to End the Month

Yield spreads generally widened as volatility picked up in the middle of the month. However, many sectors recovered to end the month tighter. High Yield spreads were the most volatile, starting at 424 bps, widening to 490 bps by mid-month and then tightening to 415 bps by month end. Accommodative policy comments from normally "hawkish" St. Louis Fed President James Bullard on the 16th appear to have helped ease some of the market concerns. Investment grade corporates ended the month marginally wider as investors favored high quality Treasuries; but high quality MBS, CMBS, and ABS spreads actually tightened slightly.

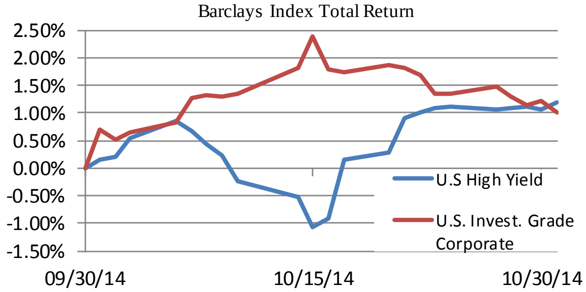
Option-Adjusted Spreads (in bps)

	12/31/13	9/30/14	10/31/14	1Mo Change	YTD Change
U.S. Aggregate Index	45	43	44	1	-1
U.S. Agency (non-mortgage)	17	16	16	0	-1
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	34	30	27	-3	-7
Asset-Backed Securities	55	56	55	-1	0
CMBS	126	99	97	-2	-29
Corporate Sectors					
U.S. Investment Grade	114	112	118	6	4
Industrial	114	115	122	7	8
Utility	125	106	109	3	-16
Financial Institutions	109	107	112	5	3
U.S. High Yield	382	424	415	-9	33

Source: Barclays

High Yield vs. IG Corporate

Barclays Index Total Return



High Yield Recovers from Volatile Drop

Declining yields contributed to solid monthly returns across the fixed income market. After falling by as much as -1.06% intra-month (see chart at left), Corporate High Yield managed to end the month with the strongest sector returns (+1.19%). Investment Grade Corporates (+1.02%) came in a close second after leading most of the month.

Total Returns of Selected Barclays Indices and Subsectors

Barclays Index/Sector	October	YTD
U.S. Aggregate Index	0.98%	5.12%
U.S. Gov't/Credit Index	0.99%	5.15%
U.S. Intermediate Gov't/Credit Index	0.70%	2.94%
U.S. 1-3 Yr. Gov't/Credit Index	0.28%	0.88%
U.S. Treasury	0.97%	4.07%
U.S. Agency	0.63%	3.04%
MBS (Mortgage Backed Securities)	0.97%	5.23%
CMBS (Commercial Mortgage Backed Securities)	0.92%	3.32%
ABS (Asset Backed Securities)	0.51%	1.84%
U.S. Corporate - Investment Grade	1.02%	6.68%
Corporate High Yield	1.19%	4.72%
Municipal Bond Index	0.69%	8.32%
TIPS (Treasury Inflation Protected Securities)	0.85%	4.55%

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.