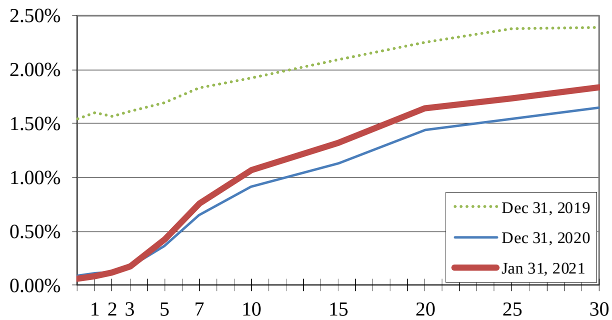
Baird Advisors
Fixed Income Market Commentary
January 2021

Curve Steepens Modestly, Biden Sworn In as U.S. President, Vaccination Efforts Continue

The 10yr Treasury yield rose 15 bps to end the month at 1.07% while short rates fell 3 bps. The steepening of the curve was due to expectations of increased stimulus after Democrats swept the two Senate run-off elections in Georgia and now control both chambers of Congress and the Presidency. Congress and President Biden continue to debate the size of another round of fiscal relief as the President has proposed $1.9T and Republicans countered with a package totaling around $600B. As expected, the Fed opted to keep rates unchanged and asset purchases steady at $120B/month as Fed Chair Powell maintained a dovish tone. He stated, “When the time comes to raise interest rates, we’ll certainly do that, and that time, by the way, is no time soon.” Covid-19 continues to impact nearly every aspect of life, though vaccination efforts are underway and it appears as though the U.S. cases may have peaked in early January, from a little over 250,000 new cases per day measured on seven-day moving average to just under 150,000 cases per day at month end.

Treasury Yields



Maturity	12/31/19	9/30/20	12/31/20	1/31/21	1Mo Chg
3 Mo	1.55%	0.10%	0.09%	0.06%	-0.03%
1	1.60%	0.12%	0.11%	0.08%	-0.03%
2	1.57%	0.13%	0.12%	0.11%	-0.01%
3	1.61%	0.15%	0.17%	0.17%	0.00%
5	1.69%	0.27%	0.36%	0.42%	0.06%
7	1.83%	0.47%	0.65%	0.76%	0.11%
10	1.92%	0.68%	0.92%	1.07%	0.15%
30	2.39%	1.45%	1.65%	1.83%	0.19%

Spreads Mixed Across Market Segments in January

U.S. Investment Grade Corporates widened 1 bp overall, with the modest widening in Financials and Industrials offsetting the tightening in Utilities. Spreads on MBS/ABS sectors ground tighter during the month on expectations of a larger stimulus plan and hopes that the vaccine rollout would accelerate, allowing the economy to reopen more fully. U.S. Agency Pass-Through spreads tightened 21 bps to end the month at only 18 bps; roughly half of this tightening was not performance driven, but rather the effect of index provider Bloomberg’s prepayment model update. The new update assumes faster prepayments due to greater refinancing at record low rates. The other half of the tightening was largely due to continued Fed buying of $40B net/month. Non-Agency CMBS tightened 13 bps on low supply in the sector and strong demand partly driven by hopes of continued improvement in fundamentals as the vaccine becomes more widely available.

Option-Adjusted Spreads (in bps)

	12/31/19	9/30/20	12/31/20	1/31/21	1Mo Chg
U.S. Aggregate Index	39	60	42	36	-6
U.S. Agency (non-mortgage)	10	16	10	7	-3
Mortgage and ABS Sectors					
U.S. Agency Pass-throughs	39	61	39	18	-21
U.S. Agency CMBS	53	62	44	40	-4
U.S. Non-Agency CMBS	85	139	109	96	-13
Asset-Backed Securities	44	41	33	26	-7
Corporate Sectors					
U.S. Investment Grade	93	136	96	97	1
Industrial	99	140	101	102	1
Utility	97	141	106	103	-3
Financial Institutions	80	126	83	84	1
Other Govt. Related	72	84	66	63	-3
U.S. High Yield Corporates	336	517	360	362	2
Emerging Market Debt	573	638	503	510	7

Source: Bloomberg Barclays Indices

Sector Returns Mixed Though Indices Generally Negative

As rates rose on 4-year and longer maturities, the returns in major taxable sectors were generally negative, particularly those with longer durations, such as Investment Grade Corporates (-1.28%), U.S. Treasuries (-0.96%) and EM Debt (-0.95%). However, some sectors – especially those with shorter durations – had modestly positive returns during the month, including High Yield Corporates (+0.33%), ABS (+0.14%), and Agency Pass-Throughs (+0.08%). Additionally, the Municipal Bond Index posted a +0.64% return for the month as strong inflows continued into the municipal market on expectations of state and local aid in the next pandemic relief package and the rising possibility of higher marginal tax rates under the Biden administration.

Total Returns of Selected Bloomberg Barclays Indices and Subsectors

	2020	January	Effective Duration (years)
U.S. Aggregate Index	*7.51%*	-0.72%	6.09
U.S. Gov’t/Credit Index	*8.93%*	-1.04%	7.62
U.S. Intermediate Gov’t/Credit Index	*6.43%*	-0.28%	4.13
U.S. 1-3 Yr. Gov’t/Credit Index	*3.33%*	0.03%	1.91
U.S. Treasury	*8.00%*	-0.96%	7.10
U.S. Agency (Non-Mortgage)	*5.48%*	-0.16%	3.71
U.S. Agency Pass-Throughs	*3.87%*	0.08%	2.20
CMBS (Commercial Mortgage-Backed Securities)	*8.11%*	-0.03%	5.26
ABS (Asset-Backed Securities)	*4.52%*	0.14%	2.07
U.S. Corporate Investment Grade	*9.89%*	-1.28%	8.70
U.S. High Yield Corporates	*7.11%*	0.33%	3.68
Emerging Market Debt	*4.26%*	-0.95%	5.32
Municipal Bond Index	*5.21%*	0.64%	5.11
TIPS (Treasury Inflation Protected Securities)	*10.99%*	0.33%	7.91

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.

JG2020-1203*