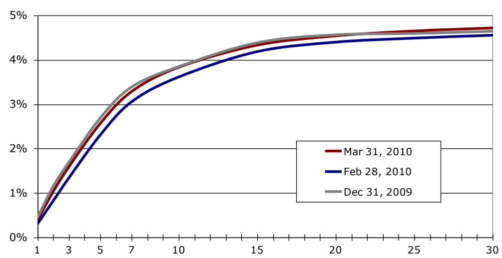
**Baird Advisors**
**Fixed Income Market Comments**
**March 2010**

### Treasury Yields Up in March, Down for the Quarter

Treasury yields rose by as much as 25 bps in March as investor demand had trouble keeping up with heavy supply. Disappointing results for the Treasury's 2, 5 and 7-year auctions (total new supply of $118 billion) triggered the sell-off in the 3rd week of March. Anticipation of the March 31 termination date for the Fed's secondary market purchases of Government Agencies and Agency mortgage pass-throughs also contributed to the market's decline. Since announcing its purchase program last March, the Fed has invested over $1.7 trillion in these two sectors and U.S. Treasuries ($1.3 trillion focused in Agency MBS) with the goal of keeping interest rates low. While 10-year Treasury yields have risen over 115 bps during the last 12 months, the Fed's efforts have kept mortgage rates relatively stable. For the quarter, Treasury yields fell about 10 bps and the yield curve steepened as the difference between 2 and 30-year Treasury yields increased to 370 bps on March 31 from 350 bps at year end (see chart and table below).

**Treasury Yields**
Source: Bloomberg




| Maturity | Dec 31, 2009 | Feb 28, 2010 | Mar 31, 2010 | 1 mo. change | Q1 change |
|---|---|---|---|---|---|
| 1 | 0.44% | 0.29% | 0.38% | 0.09 | -0.06 |
| 2 | 1.14% | 0.81% | 1.02% | 0.21 | -0.12 |
| 3 | 1.68% | 1.33% | 1.58% | 0.25 | -0.10 |
| 7 | 3.38% | 3.05% | 3.28% | 0.23 | -0.10 |
| 10 | 3.84% | 3.61% | 3.83% | 0.22 | -0.01 |
| 30 | 4.64% | 4.56% | 4.72% | 0.16 | 0.08 |

### Municipal Ratings Being Revised

Both Moody's and Fitch recently announced that they would be "recalibrating" their municipal bond ratings according to global ratings scales that are used for other [taxable] fixed income sectors. These revisions, which had been *encouraged* by a number of sources, not the least of which was Congress, were initially announced in 2008, but then suspended later that year in the midst of the financial crisis. The changes will now be implemented in April and will have the net effect of raising ratings on some issues by 1-3 notches. For example, Moody's presently rates California general obligation (G.O.) issues Baa1; the new rating is projected to rise to A3. The timing of these revisions is interesting in that they come at a time when many municipal credit ratings are on negative watch due to the tough economic environment and unprecedented budgetary challenges confronting many municipalities. Both Moody's and Fitch have stated that the ratings changes should not be interpreted as an improvement in the credit quality of affected issues. Nonetheless, it is anticipated that these ratings adjustments could have some marginal positive impact on municipal bond prices, particularly for securities that stand to ascend across a major notch (e.g. from BBB to A). S&P had been earlier to act and has been adjusting ratings of issues in sectors they believe to be under-rated by global standards since 2009.

### Tough Month, Good Quarter Overall

The increase in yields during the month resulted in negative returns for most sectors and indices in March, but the bond market overall still had a good first quarter with solid, positive returns across the board (see table below). Commercial mortgage-backed securities (CMBS) continued their dominance of investment grade sectors from 2009 with a stand-out 1st quarter return of +9.10%. Asset-backed securities (ABS) and corporates followed with strong 1st quarter returns of +2.22% and +2.30% respectively. Heavy supply caused Treasuries and municipals to struggle in March (-0.85% and -0.24% respectively) but 1st quarter returns stayed positive (+1.12% and +1.25%). High yield bonds continued to bounce in concert with equities in March (+3.13%) and returned +4.62% for the quarter. After falling in February, TIPS posted a positive return in March and in the 1st quarter (+0.13%, +0.56%).

**Total Returns of Selected Barclays Capital Indices and Subsectors**

| Index/Sector | March | Q1 2009 |
|---|---|---|
| BC Aggregate Index | -0.12% | 1.78% |
| BC Gov't/Credit Index | -0.35% | 1.55% |
| BC Int. Gov't/Credit Index | -0.28% | 1.54% |
| BC 1-3 yr. Gov't/Credit Index | -0.11% | 0.89% |
| US Treasury Sector | -0.85% | 1.12% |
| Gov't Agency Sector | -0.36% | 1.19% |
| Corporate Sector | 0.30% | 2.30% |
| MBS Sector | 0.03% | 1.54% |
| CMBS Sector | 2.45% | 9.10% |
| ABS Sector | 0.06% | 2.22% |
| High Yield Sector | 3.13% | 4.62% |
| Municipal Sector | -0.24% | 1.25% |
| TIPS | 0.13% | 0.56% |

*Indices and subsectors are unmanaged and an investment cannot be made directly in an index or a sector*