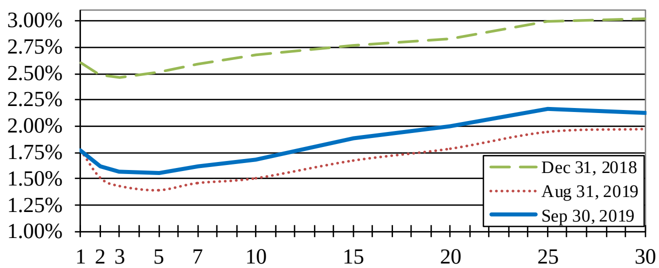
Baird Advisors
Fixed Income Market Commentary
September 2019

Yields Higher in September, Lower for the Quarter, as Global Growth Weakens & Geopolitical Woes Continue

September started with a sharp rise in U.S. Treasury yields (the 10yr rose from 1.50% to 1.90%) and a steeper yield curve. U.S. economic data, including average hourly earnings (+0.4% MoM, +3.2%YoY) and core CPI (+0.3% MoM, +2.4% YoY), beat market expectations and showed signs of firming inflation and continued U.S. labor market strength supporting the U.S. consumer. However, rates fell in the second half of September as the Fed met market expectations and cut their target rate for the second time this year to a target range of 1.75%-2.00%. The Fed decision followed the ECB's announcement to cut rates deeper into negative territory (policy rate fell 10 bps to -50 bps) and to commit to a new, open-ended, round of asset purchases starting in November. These major central bank decisions continued the theme this year of easier monetary policy to combat weakening global growth (especially in manufacturing) due primarily to trade policy tensions, which has contributed to a growing percentage of yields in negative territory. Political uncertainty abroad, both in the UK where Prime Minister Johnson's decision to suspend Parliament was deemed unconstitutional with the October 31st Brexit deadline fast approaching and in Hong Kong where protests against mainland China interference continue, added to market concerns. In the U.S., House Speaker Pelosi commenced an impeachment inquiry into a whistleblower's allegation that President Trump withheld military aid from Ukraine to gain political advantage over former Vice President Biden in the 2020 race. Adding to the global risks, an Iranian attack on Saudi Arabia's oil fields, which initially cut Saudi production by 50%, caused a temporary spike in global oil prices, sparking both inflation and potential retaliatory concerns. Tensions eased somewhat when the U.S. elected to tighten sanctions against Iran and to solicit a coordinated global response rather than direct military action.

Treasury Yields



Maturity	12/31/18	6/30/19	8/31/19	9/30/19	1Mo Chg	Q3 Chg	YTD
1	2.60%	1.93%	1.77%	1.77%	0.00%	-0.16%	-0.83%
2	2.49%	1.74%	1.51%	1.62%	0.11%	-0.12%	-0.87%
3	2.46%	1.70%	1.43%	1.56%	0.13%	-0.14%	-0.90%
5	2.51%	1.76%	1.39%	1.55%	0.16%	-0.21%	-0.96%
7	2.59%	1.87%	1.46%	1.62%	0.16%	-0.25%	-0.97%
10	2.68%	2.00%	1.50%	1.68%	0.18%	-0.32%	-1.00%
30	3.02%	2.53%	1.97%	2.12%	0.15%	-0.41%	-0.90%

Corporate Spreads End Quarter Unchanged Amidst Heavy Supply

In spite of the shifting macro risk environment, corporate spreads ended the quarter unchanged at 115 bps. During the month spreads were 5 bps tighter despite $190 billion of gross supply, the third highest month ever, from 130 unique issuers. However, while gross supply was up 37% compared to September 2018, net supply was down 18% as many issuers used the proceeds from issuance to reduce debt and/or extend maturities by tendering for shorter-maturity debt. Emerging market debt underperformed during the quarter as spreads moved sharply wider (+108 bps) ending the quarter at 612 bps, driven primarily by Argentina's worsening currency crisis.

Long-Duration Sectors Outperform in Q3

Sectors with exposure out the curve posted the best returns this quarter. Corporates posted the strongest quarterly (+3.05%) and YTD (+13.20%) returns, driven by the combination of longer duration with falling yields as well as tighter spreads YTD. Shorter-duration sectors posted much more modest returns this quarter, and EM Debt (-2.11%) was an outlier with negative returns. All sectors and indices remain solidly in positive territory YTD.

Option-Adjusted Spreads (in bps)

	12/31/18	6/30/19	8/31/19	9/30/19	1Mo Chg	Q3 Chg	YTD Chg
U.S. Aggregate Index	54	46	48	46	-2	0	-8
U.S. Agency (non-mortgage)	16	14	10	11	1	-3	-5
Mortgage and ABS Sectors							
U.S. Agency Pass-throughs	35	46	47	46	-1	0	11
U.S. Agency CMBS	55	47	51	52	1	5	-3
U.S. Non-Agency CMBS	107	83	82	82	0	-1	-25
Asset-Backed Securities	53	41	34	37	3	-4	-16
Corporate Sectors							
U.S. Investment Grade	153	115	120	115	-5	0	-38
Industrial	157	120	128	121	-7	1	-36
Utility	144	115	116	113	-3	-2	-31
Financial Institutions	147	103	107	103	-4	0	-44
Other Govt. Related	90	78	77	78	1	0	-12
U.S. High Yield Corporates	526	377	393	373	-20	-4	-153
Emerging Market Debt	560	504	640	612	-28	108	52

Source: Bloomberg Barclays Indices

Total Returns of Selected Bloomberg Barclays Indices and Subsectors

	September	Q3	YTD	Effective Duration (years)
U.S. Aggregate Index	-0.53%	2.27%	8.52%	5.78
U.S. Gov't/Credit Index	-0.76%	2.64%	9.72%	6.97
U.S. Intermediate Gov't/Credit Index	-0.36%	1.37%	6.41%	3.92
U.S. 1-3 Yr. Gov't/Credit Index	-0.05%	0.69%	3.42%	1.88
U.S. Treasury	-0.85%	2.40%	7.71%	6.60
U.S. Agency (Non-Mortgage)	-0.46%	1.74%	5.98%	4.05
U.S. Agency Pass-Throughs	0.07%	1.37%	5.60%	2.73
CMBS (Commercial Mortgage Backed Securities)	-0.68%	1.89%	8.64%	5.27
ABS (Asset-Backed Securities)	-0.15%	0.92%	4.13%	2.23
U.S. Corporate Investment Grade	-0.65%	3.05%	13.20%	7.83
U.S. High Yield Corporates	0.36%	1.33%	11.41%	3.07
Emerging Market Debt	1.17%	-2.11%	7.15%	4.67
Municipal Bond Index	-0.80%	1.58%	6.75%	5.20
TIPS (Treasury Inflation Protected Securities)	-1.36%	1.35%	7.58%	4.86

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.