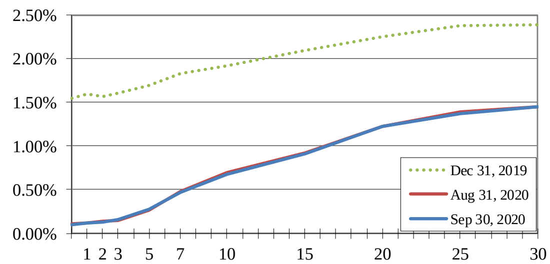
Baird Advisors
Fixed Income Market Commentary
September 2020

Yield Curve Little Changed as Fed on Hold, Virus Reaccelerates, U.S. Election Day Draws Near

The benchmark 10yr Treasury ended the month at 0.68%, 1 bp lower for the month and increasing 3 bps for the quarter. The slope of the yield curve was virtually unchanged in September and only modestly steeper for the quarter even as economic data recovered strongly in Q3. Implied Treasury volatility, as measured by the MOVE index, hit an all-time low late in the month after the Fed released its updated statement of economic projections and guidance for keeping its target for the Fed Funds rate at the zero bound through the end of 2023. Consumer confidence exceeded expectations (+15.5 in September to 101.8) and employment continued to improve. Housing has been especially strong, proving to be one of the strongest segments of the economy to recover from virus-induced shutdowns (pending home sales up 9% m/m and 21% y/y). Nonetheless, the pandemic continues to impact nearly all aspects of the economy, as ongoing efforts to contain the virus will persist until an effective vaccine can be broadly distributed. Even so, transmission of the virus has recently reaccelerated, particularly in the Midwest. Recent indications are that a vaccine may be available in limited quantities under an FDA Emergency Use Authorization (EUA) some time in November. Treasury Secretary Mnuchin and House Speaker Pelosi are making a last ditch effort to get a second fiscal relief package passed; talks have been in the $1.5T-$2.2T range, though doubts remain about whether a bill could pass before the November election. President Trump nominated Amy Coney Barrett to fill the Supreme Court vacancy and a confirmation vote is expected in the Senate prior to the November 3rd election. With one month until election day, the Presidential campaign continued in full force, including the first presidential debate.

Treasury Yields



Maturity	12/31/19	6/30/20	8/31/20	9/30/20	1Mo Chg	Q3 Chg	YTD
3 Mo	1.55%	0.15%	0.10%	0.10%	0.00%	-0.05%	-1.45%
1	1.60%	0.16%	0.12%	0.12%	0.00%	-0.04%	-1.48%
2	1.57%	0.15%	0.13%	0.13%	0.00%	-0.02%	-1.44%
3	1.61%	0.18%	0.15%	0.15%	0.00%	-0.03%	-1.46%
5	1.69%	0.29%	0.26%	0.27%	0.01%	-0.02%	-1.42%
7	1.83%	0.49%	0.48%	0.47%	-0.01%	-0.02%	-1.36%
10	1.92%	0.65%	0.69%	0.68%	-0.01%	0.03%	-1.24%
30	2.39%	1.41%	1.45%	1.45%	0.00%	0.04%	-0.94%

Mixed Spread Changes for September; Tighter for the Quarter

U.S. Investment Grade Corporate spreads widened 7 bps in the month and tightened 14 bps for the quarter to end at 136 bps as issuers continued to take advantage of record low yields, bringing a greater-than-expected $205B of gross issuance to market. High Yield Corporates widened 40 bps in the month (tightened 109 for the quarter) to 517 bps as uncertainty around the timing or size of a possible second fiscal relief package weighed on spreads. In contrast, strong demand helped Non-Agency CMBS tighten 9 bps and 39 bps for the month and quarter, respectively, to 139 bps, although the sector remains one of the widest-trading high-quality sectors as the outlook for certain commercial property types like hotels and retail remains uncertain. In spite of an uptick in issuance, Asset-Backed Securities tightened another 5 bps in September (27 for the quarter) to 41 bps, making it the only sector with YTD spread tightening thanks to robust investor demand for AAA rated spread in the front of the curve.

Option-Adjusted Spreads (in bps)

	12/31/19	6/30/20	8/31/20	9/30/20	1Mo Chg	Q3 Chg	YTD Chg
U.S. Aggregate Index	39	68	57	60	3	-8	21
U.S. Agency (non-mortgage)	10	21	17	16	-1	-5	6
Mortgage and ABS Sectors							
U.S. Agency Pass-throughs	39	70	56	61	5	-9	22
U.S. Agency CMBS	53	69	59	62	3	-7	9
U.S. Non-Agency CMBS	85	178	148	139	-9	-39	54
Asset-Backed Securities	44	68	46	41	-5	-27	-3
Corporate Sectors							
U.S. Investment Grade	93	150	129	136	7	-14	43
Industrial	99	156	135	140	5	-16	41
Utility	97	146	134	141	7	-5	44
Financial Institutions	80	139	117	126	9	-13	46
Other Govt. Related	72	97	82	84	2	-13	12
U.S. High Yield Corporates	336	626	477	517	40	-109	181
Emerging Market Debt	573	744	647	638	-9	-106	65

Source: Bloomberg Barclays Indices

Mixed Returns for the Month; Solid Returns for the Quarter

Most high-quality sectors generated modest positive returns in the month including Treasuries (+0.14%), U.S. Agencies (+0.20%), CMBS (+0.34%), and ABS (+0.13%). However, Agency Pass-throughs (-0.11%) lagged due to a continued refinancing wave as the Freddie Mac 30yr Market Survey rate hit an all-time low of 2.86% early in the month. High Yield (-1.03%) moved lower in tandem with the stock market on the lack of a second fiscal relief package and virus-related concerns, while EM fund flows turned negative, contributing to Emerging Market Debt (-2.53%) posting the weakest overall fixed income returns this month.

Total Returns of Selected Bloomberg Barclays Indices and Subsectors

	September	Q3	YTD	Effective Duration (years)
U.S. Aggregate Index	-0.05%	0.62%	6.79%	6.12
U.S. Gov't/Credit Index	-0.05%	0.78%	8.04%	7.68
U.S. Intermediate Gov't/Credit Index	-0.01%	0.61%	5.92%	4.11
U.S. 1-3 Yr. Gov't/Credit Index	0.01%	0.23%	3.12%	1.92
U.S. Treasury	0.14%	0.17%	8.90%	7.24
U.S. Agency (Non-Mortgage)	0.20%	0.36%	5.44%	3.71
U.S. Agency Pass-Throughs	-0.11%	0.11%	3.62%	2.12
CMBS (Commercial Mortgage Backed Securities)	0.34%	1.71%	6.98%	5.29
ABS (Asset-Backed Securities)	0.13%	0.79%	4.14%	2.11
U.S. Corporate Investment Grade	-0.29%	1.54%	6.64%	8.68
U.S. High Yield Corporates	-1.03%	4.60%	0.62%	3.75
Emerging Market Debt	-2.53%	2.07%	-3.12%	5.18
Municipal Bond Index	0.02%	1.23%	3.33%	5.44
TIPS (Treasury Inflation Protected Securities)	-0.37%	3.03%	9.22%	5.19

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.