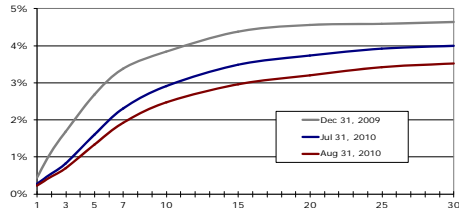


Baird Advisors
Fixed Income Market Comments
August 2010

Yields Fall Further

Treasury yields continued to plunge in August as lackluster economic data (e.g. nonfarm payrolls -131,000, pending home sales -2.6%, nonfarm productivity -0.9%) and anticipation of a second round of quantitative easing (QE2) from the Fed bolstered investor demand for bonds. Yields fell across the curve with longer-term issues experiencing the largest declines. 2-year Treasury yields fell 8 bps while 10 and 30-year yields fell by 44 bps and 47 bps respectively. The yield curve flattened with the difference between 2 and 30-year Treasury yields narrowing to 310 bps from 344 bps on July 31 (see chart and table below).



Treasury Yields

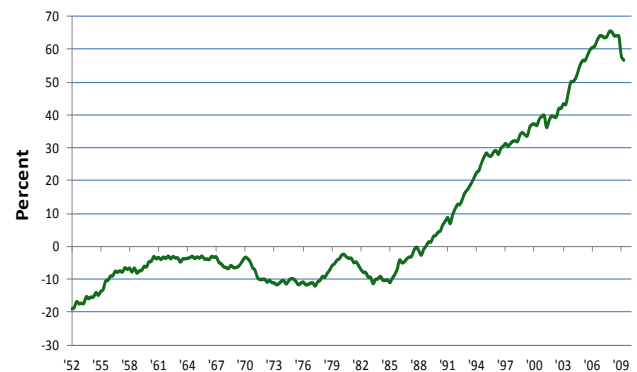
Source: Bloomberg

Maturity	Dec 31, 2009	Jul 31, 2010	Aug 31, 2010	1 Mo. Change	YTD Change
1	0.44%	0.27%	0.23%	-0.04	-0.21
2	1.14%	0.55%	0.47%	-0.08	-0.67
3	1.68%	0.82%	0.70%	-0.12	-0.98
5	2.68%	1.60%	1.33%	-0.27	-1.35
10	3.84%	2.91%	2.47%	-0.44	-1.37
30	4.64%	3.99%	3.52%	-0.47	-1.12

Deleveraging Takes Time

While consumer deleveraging is necessary and healthy in the long run, it poses a significant headwind to economic growth in the short run and is a driving factor of the current slow-growth environment. The chart at right shows the ratio of household net debt to income over the past 60 years. Much of the economic growth of the '80s and '90s resulted from higher consumer spending that was funded by a sharp increase in household debt relative to income. One could say that our traditional consumption-based economy morphed into an *over consumption-based* economy as consumers financed a higher standard of living with higher levels of debt. A long-term secular decline in interest rates over this period helped ease the cost of carrying higher levels of debt. While consumer deleveraging has clearly begun, it will likely continue for several years, posing a persistent headwind to economic growth for quite some time.

Household Net Debt to Income



Source: Mizuho Securities USA Inc.

Strong Returns

Strong demand for bonds translated into strong returns again in August. Treasuries posted a 2.01% return as investors showed a preference for quality. Municipals (+2.29%) also did well and CMBS (+2.03%) continued their dominance so far this year (+16.84% YTD) while ABS (+0.89%) and Government Agencies (+0.85%) also posted solid returns despite their more modest durations. Investors showed caution toward below-investment grade issues, however, and high yield bonds returned just 0.04% in August. Agency mortgage pass-throughs (MBS) also lagged considerably this month as renewed focus on the prepayment risks associated with mortgage pass-throughs limited the return of this sector to 0.15%. Although inflation protection was not in high demand, TIPS, which as a sector are longer in duration, still benefited from the decline in yields and posted a healthy 1.72% return. The bond market has delivered surprisingly strong returns so far this year (see table below).

Total Returns of Selected Barclays Capital Indices and Subsectors

Index/Sector	August	YTD
BC Aggregate Index	1.29%	7.83%
BC Gov't/Credit Index	1.86%	8.67%
BC Int. Gov't/Credit Index	1.17%	6.94%
BC 1-3 yr. Gov't/Credit Index	0.23%	2.61%
US Treasury Sector	2.01%	8.72%
Gov't Agency Sector	0.85%	5.48%
Corporate Sector	1.98%	10.01%
CMBS Sector	2.03%	16.84%
MBS Sector	0.15%	5.51%
ABS Sector	0.89%	7.06%
High Yield Sector	0.04%	8.27%
Municipal Sector	2.29%	7.00%
TIPS	1.72%	6.36%