

“Summer breeze makes me feel fine.”

Economic Highlights

▶ The July Federal Open Market Committee (FOMC) minutes noted that “future policy decisions should depend on the totality of the incoming information and the implications for the economic outlook and inflation.” Following that, at the annual Jackson Hole economic symposium, Federal Reserve (Fed) Chair Jerome Powell reinforced that the central bank is prepared to raise interest rates further if needed.

▶ Headline consumer price index (CPI) nudged higher in July to 3.2% over the past year, compared with 3.0% in June. The shelter component of the index was the largest contributor for July, while price increases for food moderated and airfares and used car prices fell. Excluding food and energy prices, core CPI declined to 4.7% from 4.8% year-over-year (YoY), its lowest reading in 22 months, but still well above the Fed’s 2.0% inflation target.

▶ Non-farm payrolls increased 187,000 in August, modestly beating estimates. The unemployment rate moved up from 3.5% to 3.8%, in large part due to 736,000 new entrants to the work force – a positive development for the tight labor market. Average hourly earnings rose 4.3% YoY, while job openings fell to their lowest level since March 2021.

▶ Second quarter gross domestic product (GDP) was revised lower in the second estimate to a 2.1% annual real growth rate. Personal consumption grew at 1.7%, a decline from the torrid pace of 4.2% in the first quarter. Meanwhile, third quarter GDP is shaping up to be a solid number.

▶ The ISM survey of manufacturing purchasing managers showed improvement, but remained in contractionary territory for the tenth straight month. On the other hand, the services index moved sharply higher, indicating optimism about business and economic conditions in service industries like real estate, accommodation and food service, and entertainment and recreation.

Bond Markets

▶ The U.S. government was downgraded from AAA to AA+ by Fitch Ratings, citing rising debt at the federal, state, and local levels and a “steady deterioration in standards of governance” over the past two decades. Market response was muted.

▶ Despite the downgrade, shorter-term Treasury yields were little changed over the month, although maturities seven years and longer rose 13 to 20 basis points (bps). Intra-month, yields on most Treasury maturities reached 16 year highs.

▶ The national average for a 30-year fixed-rate mortgage ended August at 7.53% — the highest monthly close since September 2000.

▶ The benchmark 1-, 2-, and 10-year U.S. Treasuries finished the month at 5.38%, 4.86%, and 4.11%, moving up 1 bp, down 1 bp, and up 15 basis points, respectively, for the month.

▶ As a result, U.S. Treasury index returns were mixed during August as shorter durations benefited from strong income returns, while longer duration issues suffered rate-induced price declines that outweighed income. The ICE BofA 1-, 2-, and 10-year U.S. Treasury indices returned 0.40%, 0.34%, and -0.94%, respectively, for the month.

Equity Markets

▶ The S&P 500 dropped 1.6% in August, reducing its year-to-date gains to 18.7%, as investors repriced equities for higher rates. For the month, the Dow Jones Industrial average lost 2.0%, while the Nasdaq declined 2.1%.

▶ International stocks, as measured by the MSCI ACWI ex-U.S. index, fell 4.5% in August, but are up 9.5% on the year.

▶ The U.S. Dollar Index (DXY) rose 1.7% in August, closing the month just shy of a year-to-date high.

PFMAM Strategy Recap

▶ The U.S. economy continues to outperform expectations, and it is possible that the Fed could enact another rate hike or, at a minimum, maintain an extended period of high rates and restrictive policy. With a deeply inverted yield curve, we will plan to maintain a modestly short and defensive duration bias while recognizing that we are nearing the end of the Fed’s aggressive rate hike cycle.

▶ Spreads on agencies, supranationals, and municipals remain tight and new issue buying opportunities have been limited. Deeply discounted low-coupon callable agencies are one area of value.

▶ Short-term credit markets (commercial paper and bank certificates of deposit) offer attractive absolute yields with levels approaching 6.0% in the 1-year maturity range, as well as decent yield pickups over government securities.

▶ Corporate spreads widened slightly in August, but remain shy of their 12-month average levels while elevated from a five year historical look-back. As credit fundamentals remain stable and the economic outlook is positive, we continue to overweight corporate allocations in portfolios. High yields and reasonable yield spreads provide a decent income cushion against potential spread widening should conditions begin to deteriorate.

▶ Asset-backed security (ABS) spreads remained relatively unchanged in August. Tighter lending standards, strong demand from investors, and lower rate volatility should support the sector over both the near- and medium-term.

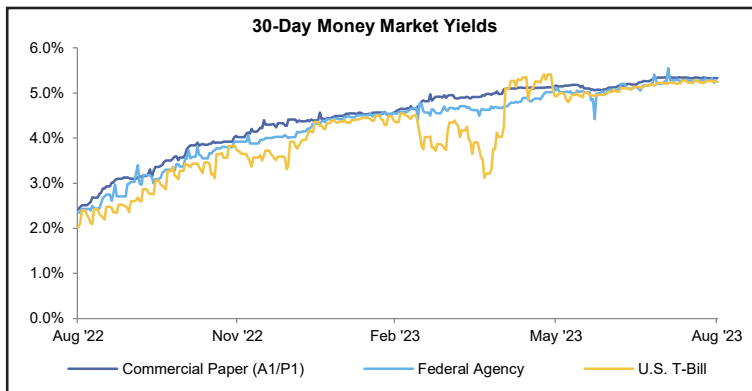
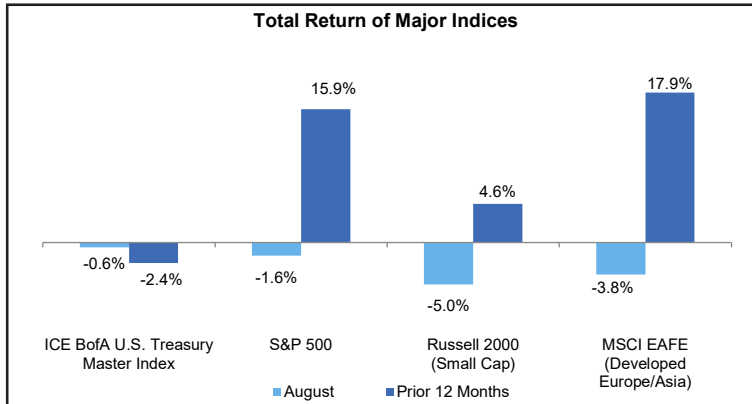
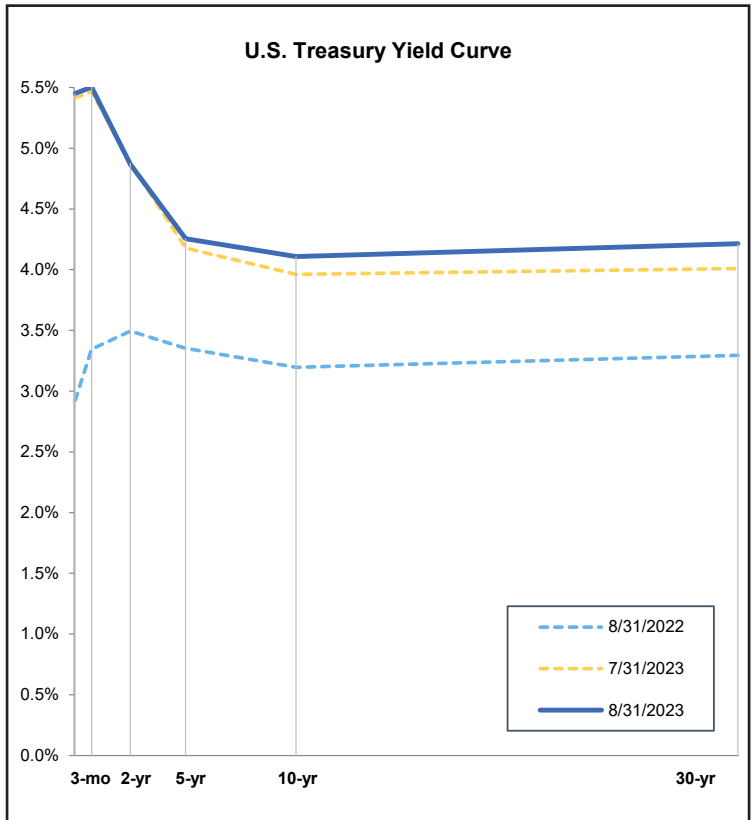
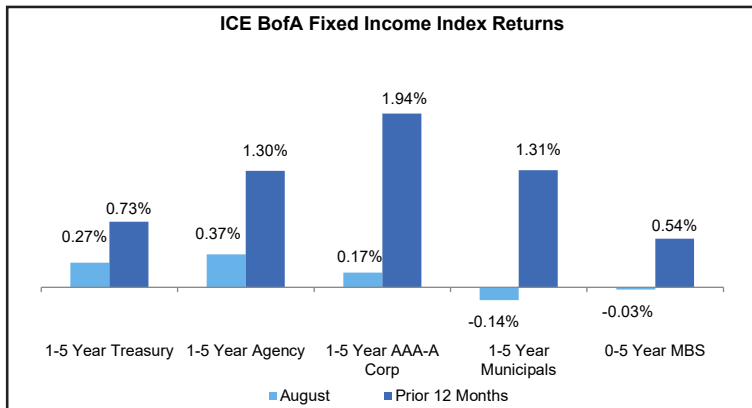
▶ Mortgage-backed securities (MBS) underperformed in August as spreads widened across all collateral types and coupons. High quality agency-backed supply is expected to remain elevated as banks lighten balance sheet exposure, providing opportunities to selectively add to portfolios at attractive levels.

U.S. Treasury Yields				
Duration	Aug 31, 2022	Jul 31, 2023	Aug 31, 2023	Monthly Change
3-Month	2.93%	5.42%	5.45%	0.03%
6-Month	3.35%	5.47%	5.51%	0.04%
2-Year	3.50%	4.88%	4.87%	-0.01%
5-Year	3.35%	4.18%	4.26%	0.08%
10-Year	3.20%	3.96%	4.11%	0.15%
30-Year	3.29%	4.01%	4.21%	0.20%

Yields by Sector and Maturity				
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	5.45%	5.37%	5.58%	-
6-Month	5.51%	5.44%	5.55%	-
2-Year	4.87%	4.91%	5.18%	3.13%
5-Year	4.26%	4.34%	4.84%	2.76%
10-Year	4.11%	4.42%	4.97%	3.00%
30-Year	4.21%	4.75%	5.31%	3.59%

Spot Prices and Benchmark Rates				
Index	Aug 31, 2022	Jul 31, 2023	Aug 31, 2023	Monthly Change
1-Month LIBOR	2.55%	5.43%	5.44%	0.01%
3-Month LIBOR	3.10%	5.63%	5.66%	0.03%
Effective Fed Funds Rate	2.33%	5.33%	5.33%	0.00%
Fed Funds Target Rate	2.50%	5.50%	5.50%	0.00%
Gold (\$/oz)	\$1,717	\$1,971	\$1,947	-\$24
Crude Oil (\$/Barrel)	\$89.55	\$81.80	\$83.63	\$1.83
U.S. Dollars per Euro	\$1.01	\$1.10	\$1.08	-\$0.02

Economic Indicators				
Indicator	Release Date	Period	Actual	Survey (Median)
CPI YoY	10-Aug	Jul	3.20%	3.30%
Retail Sales Advance MoM	15-Aug	Jul	0.70%	0.40%
U. of Mich. Consumer Sentiment	25-Aug	Aug F	69.5	71.2
GDP Annualized QoQ	30-Aug	2Q S	2.10%	2.40%
PCE Core Deflator YoY	31-Aug	Jul	4.20%	4.20%
Unemployment Rate	1-Sep	Aug	3.80%	3.50%
ISM Manufacturing	1-Sep	Aug	47.6	47



Source: Bloomberg. Data as of August 31, 2023, unless otherwise noted. The views expressed constitute the perspective of PFM Asset Management LLC at the time of distribution and are subject to change. The content is based on sources generally believed to be reliable and available to the public; however, PFMAM cannot guarantee its accuracy, completeness or suitability. This material is for general information purposes only and is not intended to provide specific advice or a specific recommendation.

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