Monthly Market Review

Fixed Income | October 2022

pfm asset management

"Fasten your seatbelts, more turbulence is expected."

Economic Highlights

► Inflation remains the headline issue as both key measures – CPI and PPI – came in hotter than expected. The consumer price index (CPI) rose 8.2% year-over-year (YoY) through September, with key contributions from food, energy, transportation and shelter costs. Despite the ongoing war in Ukraine, oil has fallen from $120/barrel earlier in the year to about $80/barrel, leading to lower gasoline prices. But lower energy prices have failed to cool "core" CPI, which rose 6.6% YoY, a new 40-year high for this cycle.

► Persistent inflation has left the U.S. Federal Reserve (Fed) with little choice but to continue its path of aggressive interest rate hikes. As monetary policy moves further into restrictive territory, expectations for a "soft landing" have been grounded at the likely cost of weaker job creation and slower growth.

► The Fed raised its policy rate again in September bringing the "summer of 75" to a close after three consecutive 75 basis point (bps) (0.75%) hikes. The target range for the overnight fed funds rate now sits at 3.00% to 3.25%, with more hikes in the cards. The Fed's own projections call for rates in the 4.25% to 4.50% range by year end, with perhaps one more 0.25% hike in early 2023.

► U.S. economic growth declined at an annual pace of 0.6% in the second quarter of 2022, the second consecutive quarter of negative real growth. Although third quarter growth is forecast to increase 2.3%, the Fed's recently updated projections reflect expectations for weaker economic growth over the coming years, with projections for the full calendar year 2022 at just 0.2%, 2023 for 1.2%, and 2024 in 1.7%.

► The U.S. labor market remained strong, adding 263,000 new jobs in September and nearly 3.8 million jobs on the year. The unemployment rate ticked down to 3.5%, while the labor force participation rate improved. Wage growth remained elevated, as average hourly earnings increased 5% over the past year.

► The housing market is feeling the impact of rising mortgage rates, which reached nearly 7% in September. Sales of existing homes fell to 10-year low (outside of two months during the pandemic), while home prices – a notoriously lagging indicator – are starting to fall. On the consumer front, retail sales have slowed materially over the last three months.

Bond Markets

► Interest rate volatility has been a major theme for fixed-income markets in 2022 and is expected to remain elevated until there is more clarity regarding the path of inflation and the subsequent pace of Fed monetary policy tightening.

► U.S. Treasury yields continue to climb and test new multi-decade highs. The benchmark 6-month, 2-, and 10-year Treasury yields finished the month at 3.90%, 4.28%, and 3.83%, up 57, 79, and 64 bps (0.57%, 0.79%, and 0.64%) for September, respectively.

► U.S. Treasury returns were mixed for the month, with shorter durations doing much better than longer ones. The ICE BofA 6-month, 2-, and 10-year Treasury indices returned 0.15%, -1.17%, and -5.28%, respectively, for the month. The 10-year posted its worst month of what was already a terrible year.

Equity Markets

► Equity markets closed out a miserable September with the S&P 500 Index posting a negative return of 9.2%, the worst monthly decline since March 2020. Year-to-date, the S&P 500 has lost nearly 24%. The Dow finished September down 8.8%, while Nasdaq posted a monthly loss of 10.4%. Global stocks, measured by the MSCI ACWI ex-U.S. index, fell 9.9%

► The U.S. dollar continued its trend higher over the past year, as the U.S. Dollar Index (DXY) advanced 3.1% in September.

PFMAM Strategy Recap

► Amid economic uncertainty, elevated bond market volatility, and the expectations for the Fed to continue to raise rates over the near term, we plan to maintain our modest defensive duration bias relative to benchmarks.

► While federal agency "bullet" securities continue to offer limited value, callable agency structures remain attractive from a historical spread perspective. With coupons now above 5% on some structures, we will likely continue to nibble at the sector, especially for government-focused accounts.

► Investment-grade (IG) corporate spreads widened in September, a reversal of the July/August downtrend. IG spreads surpassed the March and June highs and appear to be reflecting growing recession probabilities, overall economic uncertainty, and weakening corporate fundamentals. Given this view, we plan to modestly reduce our allocation to the sector and avoid industries that are more rate sensitive.

► Asset-backed security (ABS) spreads ended September modestly tighter for the month. However, a sharp reversal over the final weeks of the month mirrored the widening of corporates and has carried over into October. We favor ABS over credit, but plan to maintain allocations rather than add significantly to positions.

► Mortgage-backed securities (MBS) remained under pressure and posted very poor performance for the month and the year. But, given much improved valuations, we may cautiously increase allocations.

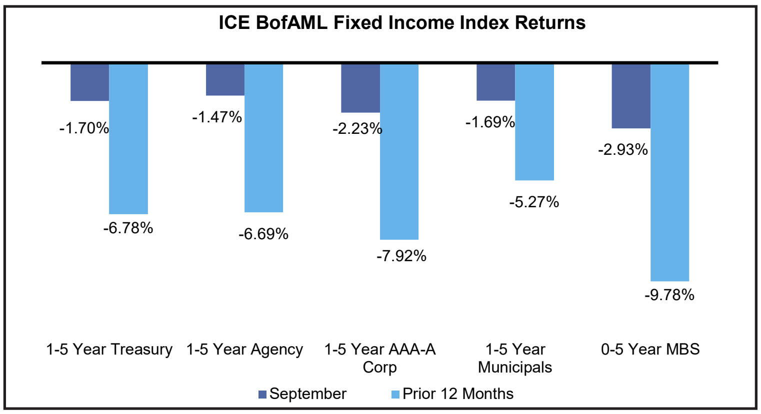
► Short-term credit instruments, including bank CDs and commercial paper, continue to offer exceptionally high yields with less rate sensitivity – and therefore less risk – than longer duration investments.

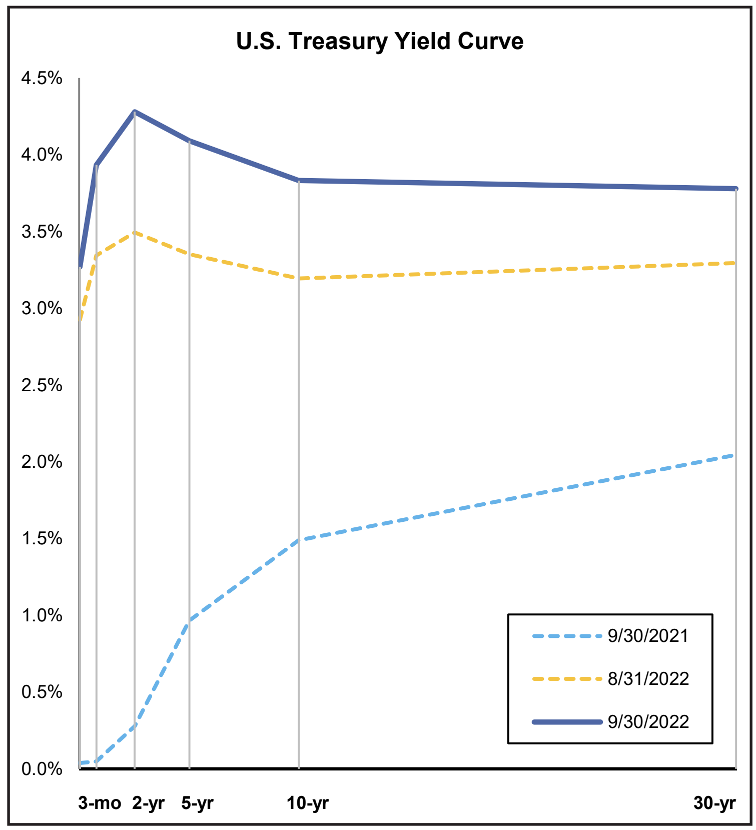
U.S. Treasury Yields				
Duration	**Sep 30, 2021**	**Aug 31, 2022**	**Sep 30, 2022**	**Monthly Change**
3-Month	0.04%	2.93%	3.27%	0.34%
6-Month	0.05%	3.35%	3.93%	0.58%
2-Year	0.28%	3.50%	4.28%	0.78%
5-Year	0.97%	3.35%	4.09%	0.74%
10-Year	1.49%	3.20%	3.83%	0.63%
30-Year	2.05%	3.29%	3.78%	0.49%

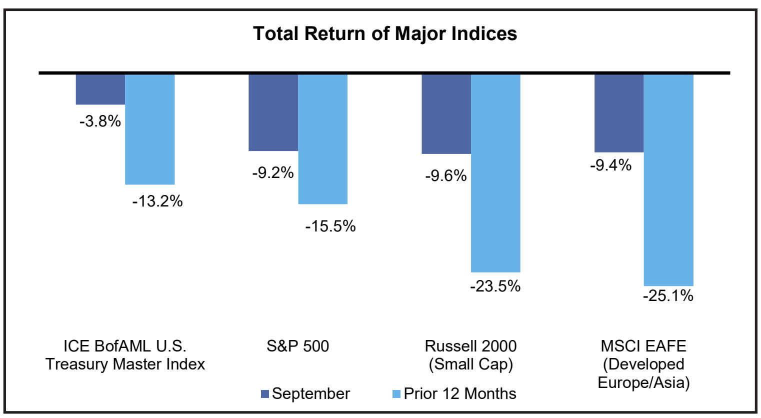
Yields by Sector and Maturity				
Maturity	**U.S. Treasury**	**Federal Agency**	**Corporates-A Industrials**	**AAA Municipals**
3-Month	3.27%	3.47%	4.16%	-
6-Month	3.93%	4.01%	4.25%	-
2-Year	4.28%	4.33%	4.64%	2.96%
5-Year	4.09%	4.19%	4.85%	3.05%
10-Year	3.83%	4.19%	5.08%	3.39%
30-Year	3.78%	4.51%	5.39%	3.94%

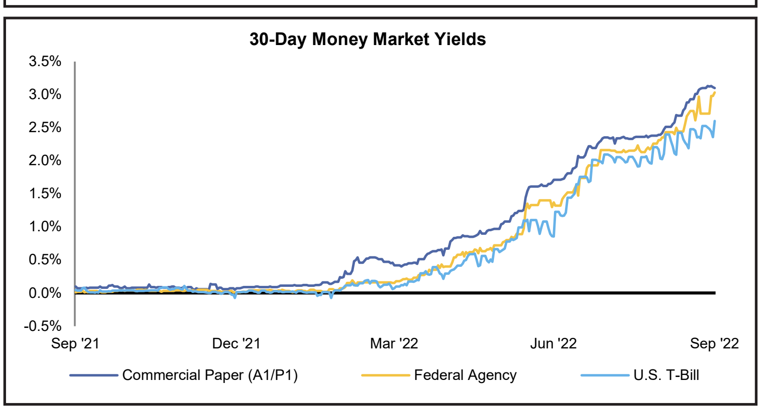
Spot Prices and Benchmark Rates				
Index	**Sep 30, 2021**	**Aug 31, 2022**	**Sep 30, 2022**	**Monthly Change**
1-Month LIBOR	0.08%	2.55%	3.14%	0.59%
3-Month LIBOR	0.13%	3.10%	3.75%	0.65%
Effective Fed Funds Rate	0.06%	2.33%	3.08%	0.75%
Fed Funds Target Rate	0.25%	2.50%	3.25%	0.75%
Gold ($/oz)	$1,755	$1,717	$1,662	-$55
Crude Oil ($/Barrel)	$75.03	$89.55	$79.49	-$10.06
U.S. Dollars per Euro	$1.16	$1.01	$0.98	-$0.03

Key Economic Indicators				
Indicator	**Release Date**	**Period**	**Actual**	**Survey (Median)**
GDP Annualized QoQ	29-Sep	2Q T	-0.6%	-0.6%
ISM Manufacturing	3-Oct	Sep	50.9	52.0
Change in Nonfarm Payrolls	7-Oct	Sep	263k	255k
Unemployment Rate	7-Oct	Sep	3.5%	3.7%
CPI ExFood&Energy YoY	13-Oct	Sep	6.6%	6.5%
Retail Sales Advance MoM	14-Oct	Sep	0.0%	0.2%
U. of Mich. Consumer Sentiment	14-Oct	Oct	59.8	58.8









Source: Bloomberg. Data as of September 30, 2022, unless otherwise noted.

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