Monthly Market Review

Fixed Income | July 2022

pfm asset management

"The dog days of summer offer no relief at the gas pump."

Economic Highlights

► Inflation remained elevated, reflecting higher energy prices, supply chain disruptions lingering from the pandemic, and continuing strong consumer demand. But, outside of oil, many commodities have returned to price levels prior to the Russian invasion of Ukraine.

► The U.S. Consumer Price Index (CPI) increased 9.1% year-over-year through June, exceeding expectations and reaching a new four-decade high. Gasoline prices led the rise, surging 60% over the past year. Other large contributors included shelter (+5.6%), food (+10.4%), new vehicles (+11.4%), transportation (+8.8%) and Medical care (+4.8%). After peaking at over $5 per gallon in June, gasoline prices were down about 50 cents by early July.

► Labor markets remained strong. Despite worker shortages, the U.S. economy added 372,000 jobs in June, outpacing estimates. The unemployment rate held steady at the post-pandemic low of 3.6%. Hourly earnings moderated 0.2%, but remained elevated at +5.1% year-over-year.

► The Federal Open Market Committee (FOMC) raised the federal funds rate by 75 basis points (bps) in June – the biggest increase since 1994 – to a new target range of 1.5%-1.75%. In their latest iteration of economic projections, the Federal Reserve (Fed) increased its expectation for inflation in 2022, lowered its forecast for real gross domestic product (GDP) and increased its projection for the year-end fed funds rate from 1.5% to 3.4%. The Fed arguably remains behind the curve when it comes to taming inflation. The FOMC will also continue reducing its holdings of Treasury securities, agency debt, and agency mortgage-backed securities, as described in the plan issued in May.

► Concerns over a possible recession continued to weigh on investor sentiment in recent weeks. As the Fed is "strongly committed" to curbing inflation, investors are increasingly concerned that aggressive monetary tightening will tip the U.S. economy into a recession.

► The University of Michigan Consumer Sentiment Index hit an all-time low in June, reflecting the high cost of everyday goods, pain at the pump and decreased wealth from sharply lower equity prices. The June index reading was lower than the post 9/11 period and the 2007-2008 global financial crisis, underscoring the deep sense of malaise being felt by the U.S. consumer.

► Manufacturing activity moderated in June, although it is still expanding. However, forward indicators such as new orders and hiring plans indicate contraction on the horizon.

Bond Markets

► The U.S. Treasury yield curve shifted higher in June as the market digested the anticipated trajectory of more aggressive Fed rate hikes. Yields on benchmark 2- and 10-year Treasury notes finished the month at 2.95% and 3.01%, up 40 and 17 bps (0.40% and 0.17%), respectively.

► As a result, returns on the U.S. Treasury index total trudged lower in June, the fifth negative month this year. The ICE BofA 2- and 10-year Treasury indices returned -0.53% and -0.86% for the month, respectively.

Equity Markets

► All three major U.S. stock indices ended down in June. Amid elevated inflation, increased uncertainty, the rising probability of a recession, and poor consumer readings, the S&P 500 and Nasdaq indices declined more than 8% in June, while the Dow Jones Industrials fell 6.6%. International stocks also fell more than 8%, as measured by the MSCI ACWI ex-U.S. Index.

► The U.S. Dollar Index (DXY) surged 2.9%, reaching the highest level in two decades.

PFMAM Strategy Recap

► Given the likely path of continued aggressive Fed rate hikes, we plan to maintain a defensive duration bias relative to benchmarks in the near-term.

► Federal agency securities continue to offer narrow yield spreads and limited value, although recent new issues have priced a bit wider.

► Investment-grade (IG) corporate spreads eclipsed their mid-March wides. We believe the markets have now adjusted for a slowing economy, and unless the U.S. economy experiences a deep recession — not our base case — we view these wider spreads as attractive entry points.

► Asset-backed security (ABS) spreads tightened modestly in June, yet remain at attractive levels. We believe consumer balance sheets remain strong and can support continued positive collateral performance.

► The mortgage-backed securities (MBS) sector continues to bear the effects of the highest mortgage rates since 2008, significant duration extensions, and the risk of further underperformance as the Fed ramps up its balance sheet tapering.

► Short-term credit markets for commercial paper and bank CDs offer excellent yields, attractive spreads over Treasuries, and some protection from the unrelenting Fed rate increases. Short-term investments are a reasonably attractive investment choice in today's rate environment.

U.S. Treasury Yields

Duration	Jun 30, 2021	May 31, 2022	Jun 30, 2022	Monthly Change
3-Month	0.04%	1.06%	1.67%	0.61%
6-Month	0.05%	1.57%	2.49%	0.92%
2-Year	0.25%	2.56%	2.96%	0.40%
5-Year	0.89%	2.82%	3.04%	0.22%
10-Year	1.47%	2.85%	3.02%	0.17%
30-Year	2.09%	3.05%	3.19%	0.14%

Yields by Sector and Maturity

Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	1.67%	1.80%	2.59%	--
6-Month	2.49%	2.20%	2.69%	--
2-Year	2.96%	3.03%	3.38%	1.96%
5-Year	3.04%	3.19%	3.81%	2.31%
10-Year	3.02%	3.40%	4.20%	2.81%
30-Year	3.19%	3.78%	4.62%	3.38%

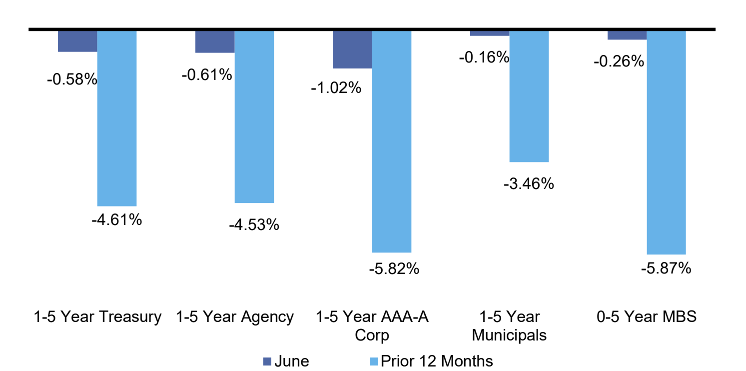
Spot Prices and Benchmark Rates

Index	Jun 30, 2021	May 31, 2022	Jun 30, 2022	Monthly Change
1-Month LIBOR	0.10%	1.12%	1.79%	0.67%
3-Month LIBOR	0.15%	1.61%	2.29%	0.68%
Effective Fed Funds Rate	0.08%	0.83%	1.58%	0.75%
Fed Funds Target Rate	0.25%	1.00%	1.75%	0.75%
Gold ($/oz)	$1,772	$1,843	$1,807	-$35
Crude Oil ($/Barrel)	$73.47	$114.67	$105.76	-$8.91
U.S. Dollars per Euro	$1.19	$1.07	$1.05	-$0.02

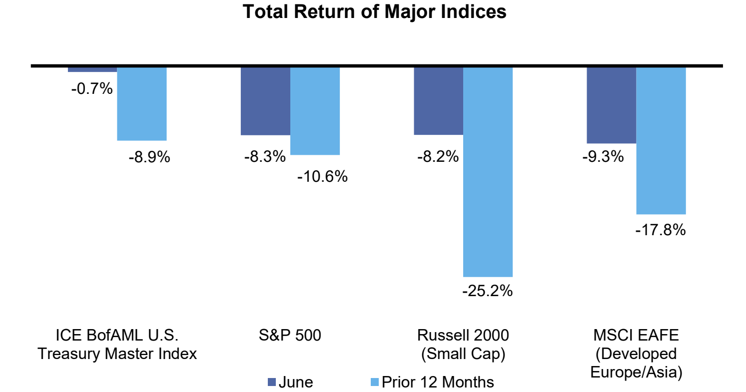
Key Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales Advance MoM	15-Jun	May	-0.3%	0.1%
GDP Annualized QoQ	29-Jun	1Q T	-1.6%	-1.5%
PCE Core Deflator YoY	30-Jun	May	4.7%	4.8%
Consumer Confidence	28-Jun	Jun	98.7	100.0
ISM Manufacturing	1-Jul	Jun	53.0	54.5
Change in Non-Farm Payrolls	8-Jul	Jun	372k	265k
Unemployment Rate	8-Jul	Jun	3.6%	3.6%

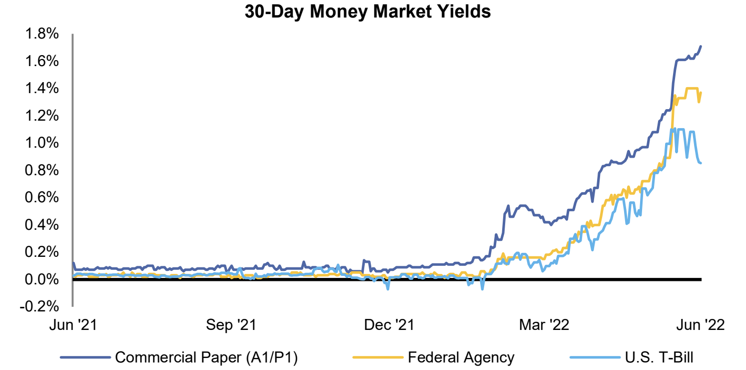
ICE BofAML Fixed Income Index Returns



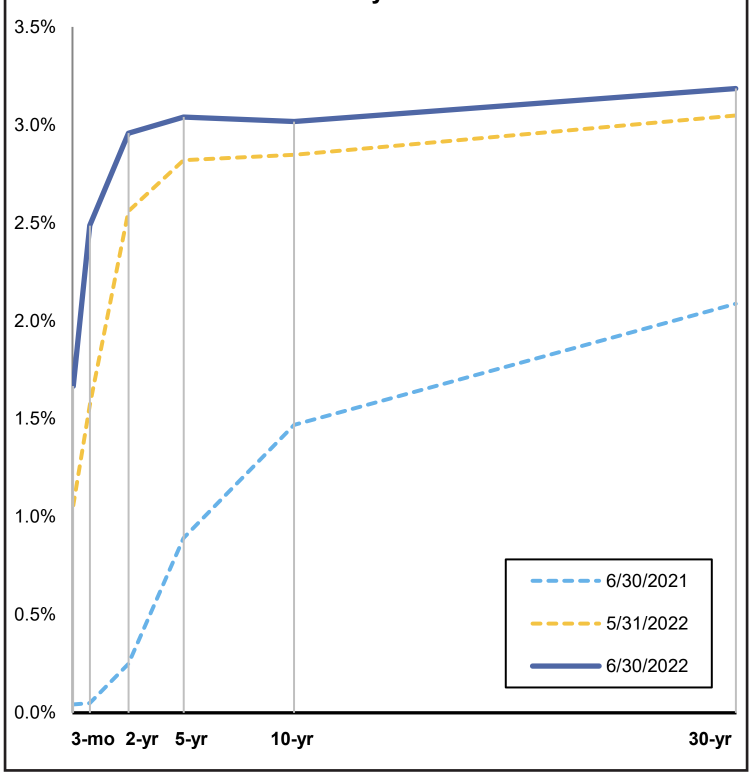
Total Return of Major Indices



30-Day Money Market Yields



U.S. Treasury Yield Curve



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

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