Monthly Market Review

Fixed Income | April 2023

pfm asset management

"The storm clears, but clouds remain."

Economic Highlights

► The Federal Reserve (Fed) raised its benchmark interest rate by 25 basis points (bps) on March 22, despite uncertainty caused by the announcement of two large bank failures in the U.S. The short-term federal funds rate is at a new target range of 4.75% to 5%. The accompanying Fed statement noted that job gains are running at a robust pace, the unemployment rate has remained low and inflation remains elevated.

► The Fed's latest Summary of Economic Projections suggest only one more 0.25% rate hike this year, with the median expectation for the target rate to remain above 5% through the end of the year. Conversely, fed funds futures contracts have diverged markedly from Fed expectations, implying that markets are betting on rate cuts to begin within six months. Fed Chair Jerome Powell has reiterated that rate cuts were not the Fed's "base case" assumption.

► Banks availed themselves of loans from the Fed amid significant money flows from banks into money market funds. The recent bank failures will likely lead to tighter credit conditions, weaken economic prospects and complicate the Fed's decision making.

► Inflation (CPI year-over-year) fell for the ninth straight month to 5% in March, the lowest reading in almost two years. This was led by a decline in all major energy component indices but was more than offset by increases in shelter costs, which has a higher relative importance in the index and was the largest contributor to the month-over-month increase.

► Employers added 236,000 jobs in March, in-line with expectations. The unemployment rate ticked lower to 3.5%. Wages grew 4.2% year-over-year, the slowest pace in 21 months, while job openings fell below 10 million for the first time in nearly two years.

► Factory orders and durable goods orders fell in February, while March readings for both the ISM manufacturing and services indices were lower. Fed district surveys from Philadelphia, New York, Kansas City, Richmond and Dallas all showed signs of weakness.

Bond Markets

► Treasury yields moved sharply lower in March on reduced rate hike expectations, recession fears and a "flight-to-quality". The 2-year Treasury yield fell 80 bps to 4.02%, reflecting increased bond market volatility which was exacerbated by recent banking concerns.

► Treasuries of all maturities rode the bond rally, as benchmark 3-month, 5-year, and 10-year U.S. Treasuries finished the month at 4.75%, 3.57%, and 3.47%, having fallen 8, 61, and 45 bps during March, respectively.

► As a result, Treasury index returns advanced in March. The ICE BofA 2-, 5-, and 10-year Treasury indices returned 1.68%, 2.89%, and 3.86%, respectively, for the month and posted their best quarterly returns in over two years.

Equity Markets

► Stocks ended March on a positive note after the year's rocky start, in which markets were whipsawed by shifting outlooks for inflation and interest rates, as well as strains on the banking system. For the month, the Dow Jones Industrial average rose 2.1%, while the S&P 500 index increased 3.7% and the Nasdaq grew 6.8%. For the quarter, the S&P rose 7.5% while the Nasdaq surged 17%.

► International stocks, measured by the MSCI ACWI ex-U.S. index, rose 2.5% for the month and 7% for the quarter.

► The U.S. dollar Index (DXY) fell 2.3% this month, retracing February's gains, largely on the heels of market expectations that the Fed is nearing the end of its rate hiking cycle.

PFMAM Strategy Recap

► Markets appear to have overpriced the potential for near-term rate cuts, making longer Treasuries expensive, with significant negative carry (lower yields vs. shorter-term options). We do not believe that current economic conditions warrant such a deeply inverted yield curve. Our strategy is to maintain our modestly defensive duration bias for now, and to await a yield backup before extending duration to move closer to benchmarks.

► Although Treasury markets rallied, most non-Treasury sectors lagged due to widening yield spreads, a typical reaction during periods of market stress. But, the spread widening was modest, and far less than the widening experienced during the global financial crisis, European sovereign debt crisis, or the early days of the pandemic.

► Caught up in market volatility, agency spreads widened, creating good investment and swap opportunities.

► After testing 10-month lows in February, investment-grade (IG) corporate spreads popped on banking sector concerns. While indices were led wider by the financials, industrial issuers also felt the pressure, albeit to a lesser extent. The simultaneous widening in many high-quality industrial names provided notable opportunities to add where value had been scarce for several months. At the same time, problems in the banking sector caused us to conduct a wholesale review of bank issuers, limiting purchases of certain issuers for a period of time.

► Asset-backed security (ABS) spreads were wider by 25-40 bps, just shy of their November 2022 wides. While corporate spreads partially retraced toward the end of the month, ABS remained elevated and offer value.

► Falling yields boosted returns on mortgage-backed securities (MBS) for a bit, but spreads eventually widened, generating underperformance versus like-duration Treasuries. We plan to use this bout of market weakness to increase allocations.

► The peak of the Treasury yield curve is now around the 6-month maturity range. Money market investors continue to benefit from the highest short-term yields in over 15 years.

U.S. Treasury Yields

Duration	Mar 31, 2022	Feb 28, 2023	Mar 31, 2023	Monthly Change
3-Month	0.50%	4.81%	4.75%	-0.06%
6-Month	1.02%	5.15%	4.88%	-0.27%
2-Year	2.34%	4.82%	4.03%	-0.79%
5-Year	2.46%	4.18%	3.58%	-0.60%
10-Year	2.34%	3.92%	3.47%	-0.45%
30-Year	2.45%	3.92%	3.65%	-0.27%

Yields by Sector and Maturity

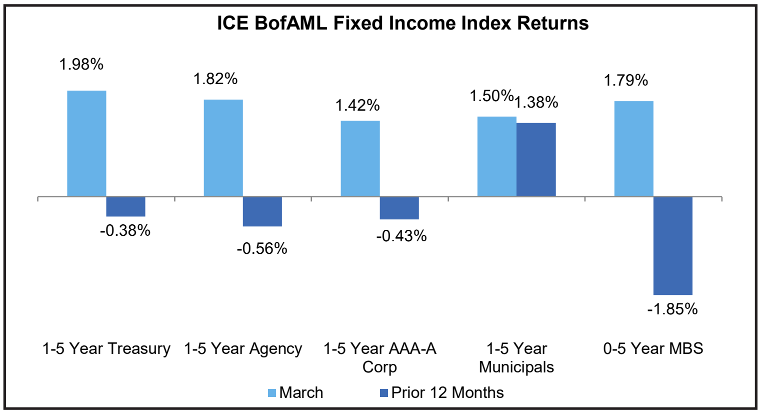
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	4.75%	4.80%	4.71%	-
6-Month	4.88%	4.83%	4.70%	-
2-Year	4.03%	4.24%	4.50%	2.44%
5-Year	3.58%	3.78%	4.28%	2.28%
10-Year	3.47%	3.86%	4.44%	2.72%
30-Year	3.65%	4.20%	4.90%	3.27%

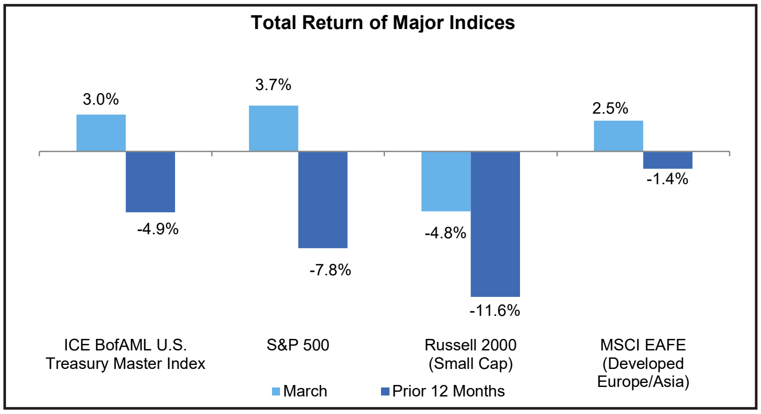
Spot Prices and Benchmark Rates

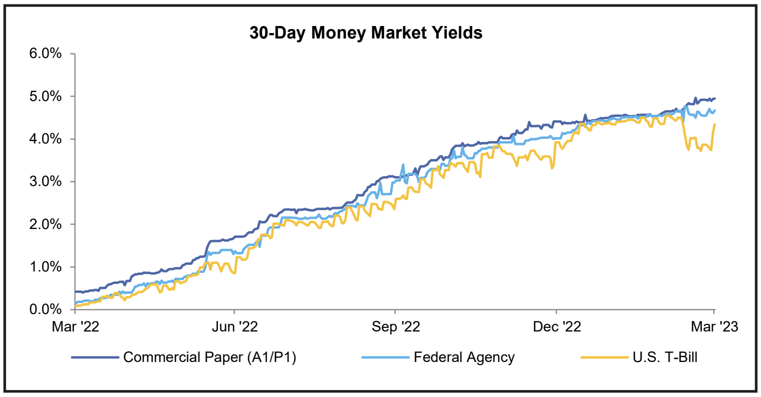
Index	Mar 31, 2022	Feb 28, 2023	Mar 31, 2023	Monthly Change
1-Month LIBOR	0.45%	4.67%	4.86%	0.19%
3-Month LIBOR	0.96%	4.97%	5.19%	0.22%
Effective Fed Funds Rate	0.33%	4.57%	4.83%	0.26%
Fed Funds Target Rate	0.50%	4.75%	5.00%	0.25%
Gold ($/oz)	$1,949	$1,837	$1,969	$132
Crude Oil ($/Barrel)	$100.28	$77.05	$75.67	-$1.38
U.S. Dollars per Euro	$1.11	$1.06	$1.08	$0.02

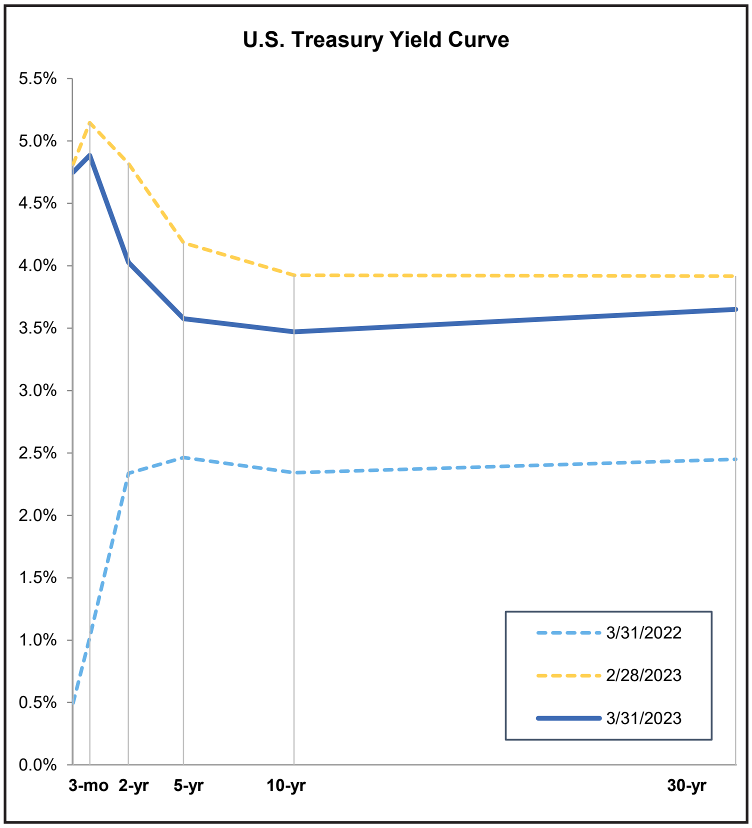
Key Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales Advance MoM	15-Mar	Feb	-0.40%	-0.40%
FOMC Rate Decision	22-Mar	M-23	4.75%	4.75%
New Home Sales MoM	23-Mar	Feb	1.10%	-3.10%
GDP Annualized QoQ	30-Mar	4Q T	2.60%	2.70%
U. of Mich. Consumer Sentiment	31-Mar	Mar F	62	63.3
Unemployment Rate	7-Apr	Feb	3.50%	3.60%
CPI YoY	12-Apr	Mar	5.00%	5.10%









Source: Bloomberg. Data as of March 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.

PFM Asset Management LLC ("PFMAM") is an investment adviser registered with the U.S. Securities and Exchange Commission and a subsidiary of U.S. Bancorp Asset Management, Inc. ("USBAM"). USBAM is a subsidiary of U.S. Bank National Association ("U.S. Bank"). U.S. Bank is a separate entity and subsidiary of U.S. Bancorp. U.S. Bank is not responsible for and does not guarantee the products, services or performance of PFMAM.

NOT FDIC INSURED : NO BANK GUARANTEE : MAY LOSE VALUE