Monthly Market Review

Fixed Income | February 2024

pfm asset management

Punxsutawney Phil prognosticates an early spring, Fed Chair Powell practices policy patience.

Economic Highlights

► The Federal Reserve (Fed) kept the overnight target rate unchanged at its current range of 5.25% to 5.50% at the conclusion of its meeting on January 31 and continued to push back on market expectations that a rate cut was imminent. In the post-meeting press conference, Chair Jerome Powell once again noted the importance of incoming data for policy decisions and balancing the risks of cutting the overnight rate too soon.

► Inflation, as measured by the year-over-year (YoY) change in the consumer price index (CPI) rose slightly to 3.4% in December mainly due to higher shelter and energy costs. Meanwhile, core CPI (which excludes food and energy) ticked down to 3.9% and maintained its 15-month trend lower. This also marked the first time since 2021 that core CPI came in below 4%.

► The labor market remains as strong as ever and is a gusty tailwind to the outlook for consumers. Monthly job growth wowed again in February as 353,000 jobs were added on the heels of January's gains of 333,000. These were the largest monthly gains in over a year. Wage growth remains robust and has now outpaced headline CPI for eight consecutive months, while the unemployment rate of 3.7% remains near all-time lows.

► Initial estimates suggest that real gross domestic product (GDP) increased at an annual rate of 3.3% in the fourth quarter of 2023, firmly besting estimates of 2.0%. Consumer spending continued to lead the way as the Q4 reading of 2.8% only modestly trailed Q3's torrid 3.1% pace.

► Strong retail sales (which do not adjust for inflation) persisted through the holiday season, increasing 5.6% YoY. The stronger-than-expected gains were broad-based and led by growth in holiday-related department stores, online retailers, and clothing stores.

► Home price appreciation continued to accelerate in November as the S&P/Case-Shiller Home Price Index increased by 5.1% YoY. The divergence between new and existing home sales deepened as the former increased 8% over the month and the latter fell to a nearly 15-year low.

Bond Markets

► The U.S. Treasury yield curve steepened over the month as maturities inside 10 years ended January modestly lower. The 10- and 30-year U.S. Treasury tenors led rates higher as the longer-term economic outlook and expectations for Fed balance sheet reductions firmed.

► The benchmark 2-, 5- and 10-year U.S. Treasuries finished the month at 4.21%, 3.84% and 3.91%, changing by -4, -1 and +3 basis points for the month, respectively.

► The policy-sensitive 2-year U.S. Treasury traded over a 25-basis point range during the month, reflecting a market that may have gotten ahead of itself as it continues to reconcile Fed guidance with economic data.

► The ICE BofA 2-, 5- and 10-year Treasury indices returned 1.12%, 2.30% and 4.04%, respectively, for the month as the benefits of higher income on fixed income securities buoyed total returns.

Equity Markets

► Equity markets maintained momentum from Q4 through January as the S&P 500 Index and Dow Jones Industrial Average both hit new all-time highs, increasing by 1.7% and 1.3% for the month, respectively. The NASDAQ Index increased by 1.0%. International equites (as measured by the MSCI ACWI ex-U.S.) finished lower by 1.0%, underscoring the modest divergence in global economic growth outlooks.

► The dollar index (DXY) jumped 1.9% in January, as markets digested Fed commentary around overnight target rate outlooks and the diminishing probability of imminent cuts.

PFMAM Strategy Recap

► We prefer a neutral duration stance relative to benchmarks as the current Fed interest rate hiking cycle has likely come to an end.

► Spreads on federal agencies and supranationals remained anchored over the month. While agency debt issuance has been light over the past several months, record issuance from supranationals to kickstart the year was met with strong demand.

► Momentum from the Q4 "risk-on" rally continued in investment-grade corporates as the sector generated positive excess returns and buoyed portfolio performance. This has driven spreads on most corporate issuers to near their 12-month lows. As a result, we may use this as an opportunity to trim allocations in the sector, booking gains and creating room to add back to the sector, while exercising patience for better entry points.

► After outperforming notably in Q4, mortgage-backed securities (MBS) were a mixed bag during January. Shorter collateral (15-year) mortgage pools posted positive excess returns, while the more rate-sensitive 30-year mortgage pools underperformed markedly as the steepening U.S. Treasury curve, led by the 30-year maturity, weighed on the sector. We continue to look to the new issue market to add agency-backed commercial MBS in the intermediate-term area of the curve.

► Asset-backed securities (ABS) performed exceedingly well through January as record issuance was met with strong demand. After lagging the spread tightening that was observed in corporates in the latter half of 2023, the sector rallied through January and ended the month at or near their summer lows.

► Short-term money market maturities continue to benefit from high yields as the curve remains inverted and the Fed reiterates policy patience. Short-term credit remains an attractive alternative to similar maturity U.S. Treasuries, despite modestly narrower spreads over the past several months.

U.S. Treasury Yields

Duration	Jan 31, 2023	Dec 31, 2023	Jan 31, 2024	Monthly Change
3-Month	4.67%	5.34%	5.35%	0.01%
6-Month	4.83%	5.26%	5.15%	-0.11%
2-Year	4.20%	4.25%	4.23%	-0.02%
5-Year	3.62%	3.85%	3.88%	0.03%
10-Year	3.51%	3.88%	3.96%	0.08%
30-Year	3.63%	4.03%	4.21%	0.18%

Yields by Sector and Maturity

Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	5.35%	5.24%	5.06%	-
6-Month	5.15%	5.08%	5.07%	-
2-Year	4.23%	4.41%	4.68%	2.74%
5-Year	3.88%	4.07%	4.48%	2.44%
10-Year	3.96%	4.27%	4.73%	2.70%
30-Year	4.21%	4.71%	5.10%	3.37%

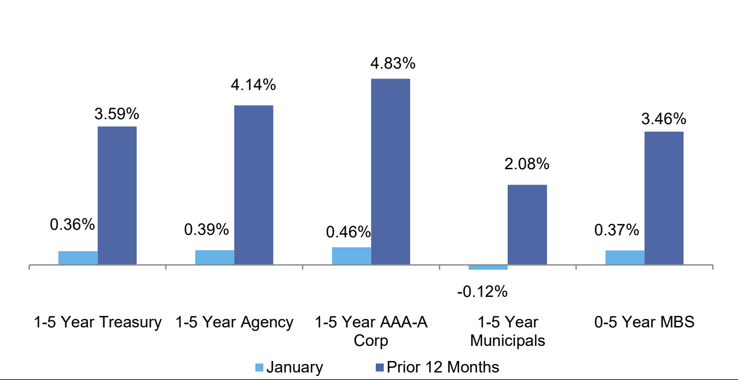
Spot Prices and Benchmark Rates

Index	Jan 31, 2023	Dec 31, 2023	Jan 31, 2024	Monthly Change
1-Month LIBOR	4.57%	5.47%	5.44%	-0.03%
3-Month LIBOR	4.81%	5.59%	5.57%	-0.02%
Effective Fed Funds Rate	4.33%	5.33%	5.33%	0.00%
Fed Funds Target Rate	4.50%	5.50%	5.50%	0.00%
Gold ($/oz)	$1,930	$2,072	$2,052	-$20
Crude Oil ($/Barrel)	$78.87	$71.65	$76.62	$4.97
U.S. Dollars per Euro	$1.09	$1.10	$1.09	-$0.01

Economic Indicators

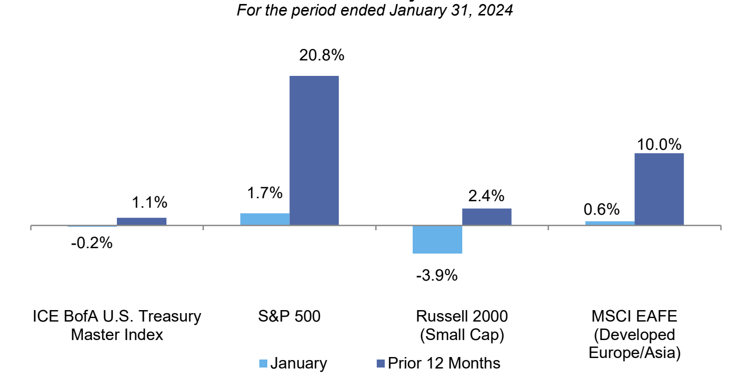
Indicator	Release Date	Period	Actual	"Survey (Median)"
CPI YoY	11-Jan	Dec	3.90%	3.80%
Retail Sales Advance MoM	17-Jan	Dec	0.60%	0.40%
GDP Annualized QoQ	25-Jan	4Q A	3.30%	2.00%
FOMC Rate Decision	31-Jan	J-24	5.50%	5.50%
Change in Nonfarm Payrolls	2-Feb	Jan	353K	185K
Unemployment Rate	2-Feb	Jan	3.70%	3.80%
U. of Mich. Consumer Sentiment	2-Feb	Jan F	79.0	78.9

ICE BofA Fixed Income Index Returns

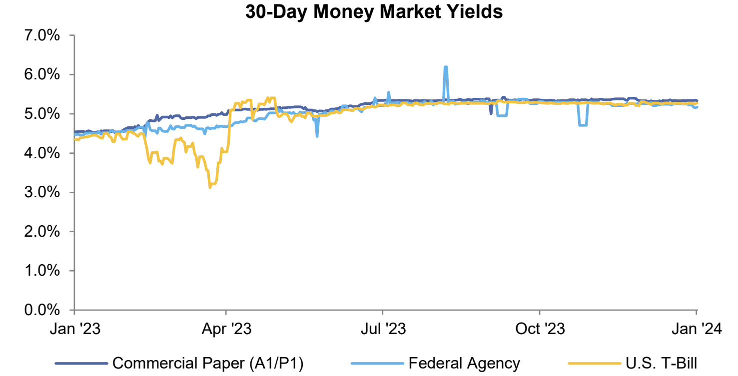


Total Return of Major Indices

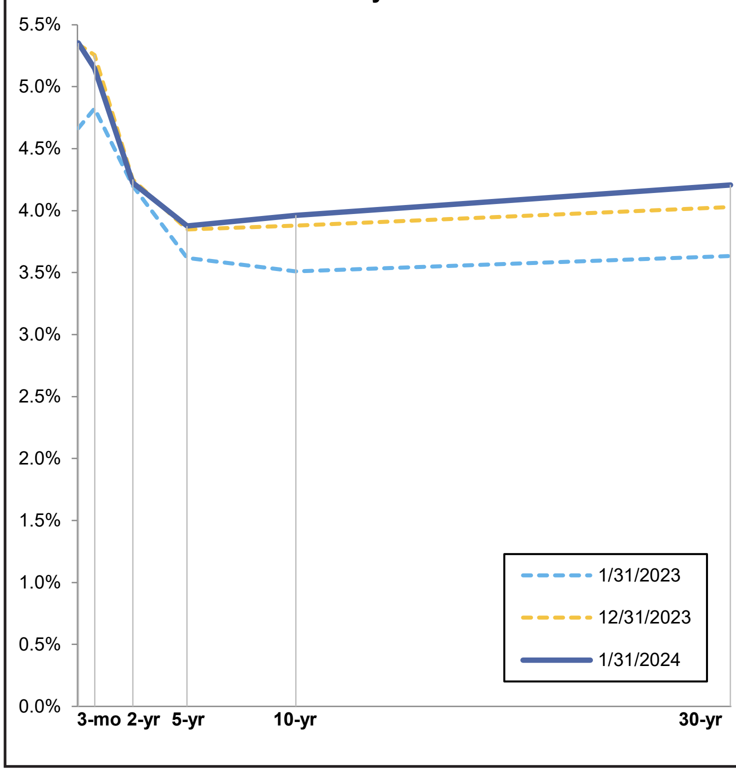
For the period ended January 31, 2024



30-Day Money Market Yields



U.S. Treasury Yield Curve



Source: Bloomberg. Data as of January 31, 2024, unless otherwise noted.

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