Monthly Market Review

Fixed Income | January 2024

pfm asset management

"On the Thirteenth day of Christmas, the Fed gave to me…"

Economic Highlights

► At the conclusion of its meeting on December 13, a surprisingly dovish Federal Reserve (Fed) suggested it had likely reached the end of its historic rate-hiking cycle. In addition to maintaining the overnight target rate at its current range of 5.25% to 5.50%, the Fed published an updated "dot plot" showing a total of three 25 basis point (bps) rate cuts by the end of 2024, more than previously projected. Yields fell notably as a result.

► The December employment report showed non-farm payrolls increased by 216,000, beating expectations, while the unemployment rate was unchanged at 3.7%. For the year, non-farm payrolls showed 225,000 new jobs created per month, down from 2022's blistering pace of 399,000, while the unemployment rate increased modestly from its historically low level at the beginning of the year. The number of job openings also fell to the lowest level since March 2021, pointing to a labor market that continues to moderate.

► Inflation (measured by the year-over-year (YoY) change in the consumer price index (CPI) fell to 3.1% in November as lower energy prices continue to offset higher shelter costs. The Fed's preferred gauge of inflation, the Personal Consumption Expenditure (PCE) index, fell slightly on a month-over-month basis between October and November, the first monthly decline in more than 3.5 years.

► After a disappointing October, retail sales (which are not adjusted for inflation) surprised to the upside in November, by increasing 0.3%. Lower prices at the gas pump helped fuel a stronger-than-expected start to the holiday shopping season. Eight of 13 spending categories showed growth, including sales at food services and drinking places, non-store retailers, health and personal care and furniture stores.

► Home prices accelerated in October as the S&P/Case-Shiller Home Price Index increased by 4.8% YoY. Mortgage rates mirrored the overall move lower in yields; however, new home sales declined 12% in December, while existing home sales remained near decade lows.

Bond Markets

► U.S. Treasury yields continued their descent from the multiyear highs reached in October and rallied significantly into year-end. The Fed's dovish tone added downward pressure on yields as policymakers appeared to affirm that easier monetary policy may be the most likely outcome in 2024.

► The benchmark 2-, 5-, and 10-year U.S. Treasuries finished the month at 4.25%, 3.85%, and 3.88%, moving down 43, 42, and 45 bps for the month, respectively.

► As a result of plunging yields, the ICE BofA 2-, 5-, and 10-year Treasury indices returned 1.12%, 2.30%, and 4.04%, respectively, for the month.

► Despite 100 bps of further Fed hikes, the 2-year U.S. Treasury actually ended the year 17 bps lower. Underscoring elevated bond volatility during the year, the range of yields on the benchmark tenor was 145 bps, including a low of 3.77% in March and a high of 5.22% in October.

Equity Markets

► December put an exclamation point on the blockbuster year for equities as market optimism ruled the day. The S&P 500 Index generated a 4.5% total return for the month, pushing the yearly total to 26.3%. Not to be outdone, however, the technology-heavy NASDAQ Index led with a 5.6% return in December and 44.7% for the year. International equites (MSCI ACWI ex-U.S.) finished 16.2% higher in 2023.

► The dollar index (DXY) declined 2% in December, nearing the lower end of its calendar year range. Gold and oil commodities diverged modestly to close the year as the former closed just shy of its all-time high, while oil prices maintained their multi-month trend lower.

PFMAM Strategy Recap

► Based on our view that the Fed has reached the end of its historic hiking cycle, we view the risk of rates moving lower as outweighing significant moves higher. As a result, we now prefer a neutral duration stance relative to benchmarks following several quarters of a modestly defensive duration bias.

► Well-diversified portfolios generated attractive returns over the month and the calendar year as most non-Treasury sectors produced firmly positive excess returns.

► Spreads on agencies, municipals, and supranationals spent the better part of the past 12 months in a very low and narrow range, largely as demand for already-light issuance persisted.

► Investment-grade (IG) corporates were a top-of-class performer in December as market optimism drove spreads modestly tighter and attractive incremental income pushed relative returns higher. Lower quality and longer duration added the most incremental value. While allocations remain at multi-year highs, we utilized these tighter valuations as an opportunity to trim holdings and free up buying power for expected upticks in early-year new issuance.

► Mortgage-backed securities (MBS) also generated strong relative performance for December as spreads rallied into year-end, finishing near nine-month lows. Longer collateral notably outperformed shorter counterparts as mortgage rates fell over 50 bps in December.

► Asset-backed securities (ABS) fell in line with other spread sectors over the month, generating positive excess returns, with credit cards modestly besting auto loans. Despite strong returns, ABS spreads closed the year elevated compared to corporates, underscoring additional opportunities in the sector as we head into the new year.

U.S. Treasury Yields

Duration	Dec 31, 2022	Nov 30, 2023	Dec 31, 2023	Monthly Change
3-Month	4.37%	5.39%	5.34%	-0.05%
6-Month	4.76%	5.40%	5.26%	-0.14%
2-Year	4.43%	4.68%	4.25%	-0.43%
5-Year	4.01%	4.27%	3.85%	-0.42%
10-Year	3.88%	4.33%	3.88%	-0.45%
30-Year	3.97%	4.50%	4.03%	-0.47%

Yields by Sector and Maturity

Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	5.34%	5.29%	5.03%	-
6-Month	5.26%	5.17%	5.02%	-
2-Year	4.25%	4.34%	4.60%	2.56%
5-Year	3.85%	3.96%	4.32%	2.29%
10-Year	3.88%	4.14%	4.55%	2.56%
30-Year	4.03%	4.53%	4.92%	3.16%

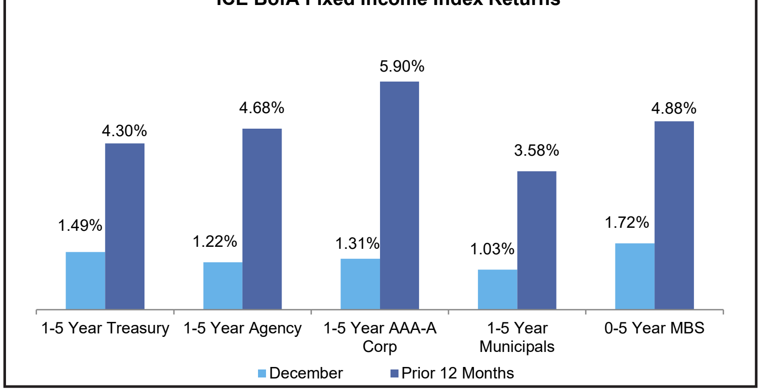
Spot Prices and Benchmark Rates

Index	Dec 31, 2022	Nov 30, 2023	Dec 31, 2023	Monthly Change
1-Month LIBOR	4.39%	5.46%	5.47%	0.01%
3-Month LIBOR	4.77%	5.63%	5.59%	-0.04%
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)	$1,826	$2,038	$2,072	$34
Crude Oil ($/Barrel)	$80.26	$75.96	$71.65	-$4.31
U.S. Dollars per Euro	$1.07	$1.09	$1.10	$0.01

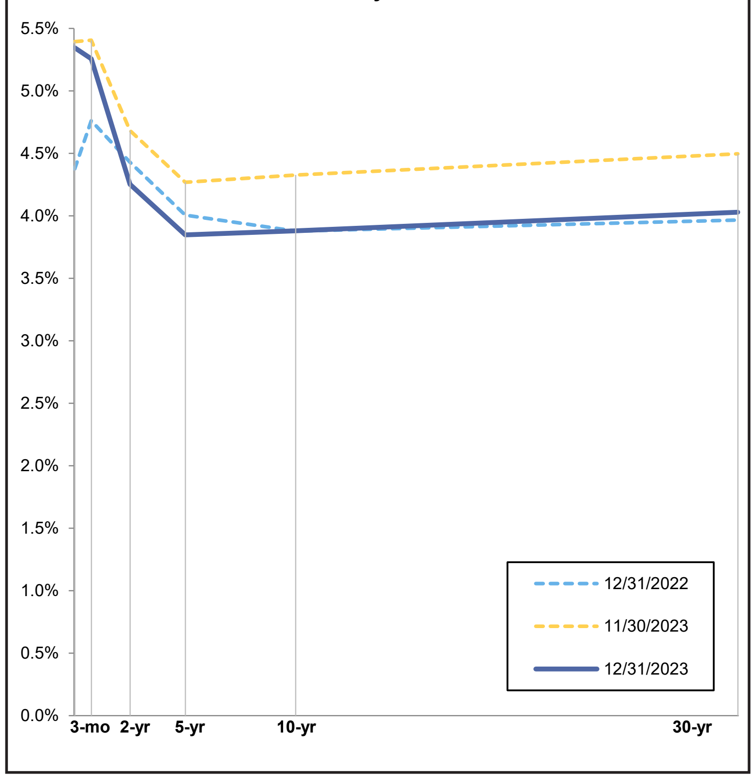
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Change in Non-farm Payrolls	8-Dec	Nov	199K	185K
Unemployment Rate	8-Dec	Nov	3.70%	3.90%
CPI YoY	12-Dec	Nov	3.10%	3.10%
FOMC Rate Decision	13-Dec	D-23	5.50%	5.50%
Retail Sales Advance MoM	14-Dec	Nov	0.30%	-0.10%
GDP Annualized QoQ	21-Dec	3QT	4.90%	5.20%
U. of Mich. Consumer Sentiment	22-Dec	Nov P	69.7	69.4

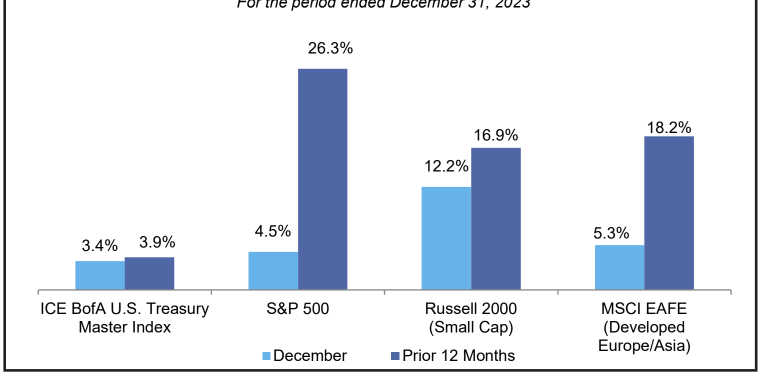
ICE BofA Fixed Income Index Returns



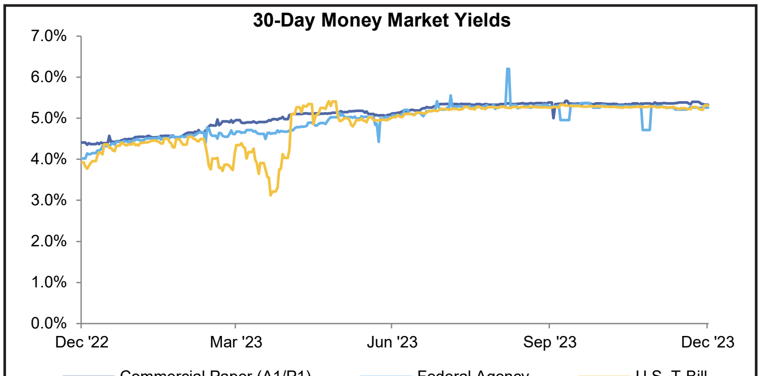
U.S. Treasury Yield Curve



Total Return of Major Indices
For the period ended December 31, 2023



30-Day Money Market Yields



Source: Bloomberg. Data as of December 31, 2023, unless otherwise noted.

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