Monthly Market Review

Fixed Income | July 2023

pfm asset management

"A bang up month for equities."

Economic Highlights

► The Federal Reserve (Fed) held its benchmark interest rate unchanged on June 14 but signaled more rate hikes are still on the table this year. The "hawkish pause" pushed Treasury yields higher as markets accepted a higher-for-longer overnight target rate expectation.

► The May CPI report indicated that prices increased by 4.0% year-over-year. While still elevated relative to the Fed's preferred target of 2%, the pace of increases declined for the eleventh consecutive month.

► The June employment report showed the slowest pace of job creation since December 2020, posting gains of 209,000. This was down from a revised reading of 306,000 in May. Employment continued to trend up in government, healthcare, social assistance, construction, professional and business services, and leisure and hospitality. The unemployment rate in June fell modestly to 3.6%, down from 3.7% in May. Average hourly earnings increased 0.4% in June, matching the May print.

► Real gross domestic product (GDP) increased at an annual rate of 2.0% in the first quarter of 2023, modestly surprising to the upside as estimates called for growth of 1.4%. The higher estimates primarily reflected upward revisions to consumer spending and exports that were partly offset by downward revisions to nonresidential fixed investment and federal government spending.

► The services sector continued to expand in June, following a trend that has continued in 36 of the last 37 months. On the other hand, the slide in the manufacturing sector continued as it posted its eighth consecutive month in contractionary territory.

► The average national 30-year mortgage rate hovered above 7% in June. Existing home sales continue to show tight inventory. On the other hand, new home sales jumped 12.2% to a seasonally adjusted annual rate of 763,000, the highest level since February 2022. Housing starts also surged in May, underscoring the strength of the consumer and the resilient housing market.

Bond Markets

► U.S. Treasury yields beyond one year pushed higher in June, led by a 0.49% increase in the 2-year maturity. The inversion in the yield curve (as measured by the difference between the 2- and 10-year maturities) deepened to more than 100 basis points (bps) by the end of the month, marking the greatest disparity between the two measures since 1981.

► With the exception of only the shortest maturities, U.S. Treasury yields increased in June, as benchmark 2-, 5-, and 10-year U.S. Treasuries finished the month at 4.90%, 4.16%, and 3.84%, moving up 49, 40, and 19 bps, respectively.

► As a result, Treasury Index returns retreated in June. The ICE BofA 2-, 5-, and 10-year Treasury indices returned -0.64%, -1.34%, and -1.19%, respectively, for the month.

Equity Markets

► Stocks rose and technology names continued their staggering run to cap off a strong start to the year, as the Nasdaq Composite posted its strongest first half gain (+32.3%) since 1983. For the month, the Dow Jones Industrial Average increased 4.7%, the Nasdaq increased 6.6%, and S&P 500 was up 6.6%.

► The U.S. dollar Index (DXY) retreated 1.4% during the month while remaining in a tight trading range as markets digested ongoing Fed monetary policy expectations.

PFMAM Strategy Recap

► Throughout the month, Fed Chair Jerome Powell reiterated that more rate hikes are likely, echoing the Fed's updated dot plot released in June, which showed two more rate hikes by December.

► Given the steady ascent of yields over the month of June and steadfast Fed speak indicating higher-for-longer overnight rates, we have maintained a modestly defensive duration bias. However, as the 2-year U.S. Treasury yield surged over 100 bps from early May lows through the end of June, we extended portfolios slowly and methodically to be closer to benchmarks. We will likely continue to maintain a marginally defensive bias as the yield curve remains near historically extreme levels of inversion.

► Spreads in non-Treasury government sectors such as agencies, supranationals and municipals remain tight. New buying opportunities are limited, and these sectors may be utilized for duration-rebalancing trades.

► Corporate spreads have continued to narrow from mid-March wide levels, generating attractive excess returns. The difference in yields of financials and industrials remains quite wide. We will likely maintain our current exposure as portfolios continue to benefit from the sector's attractive incremental income.

► Asset-backed security (ABS) spreads have tightened modestly, although not to the extent realized in the corporate sector. As a result, spreads remain wide on a relative basis and offer continued value. We expect to remain active buyers in the new issue and secondary markets as allocations are likely to inch higher.

► The mortgage backed securities (MBS) sector posted another strong performance in June as option-adjusted and nominal spreads narrowed from their April wides. With 30-year mortgage rates approximately 7%, prepayments will likely remain depressed, and security duration extensions may persist. After notable additions over the prior several months, which have been a boon for portfolio performance, we will likely maintain exposure for now.

U.S. Treasury Yields

Duration	Jun 30, 2022	May 31, 2023	Jun 30, 2023	Monthly Change
3-Month	1.67%	5.40%	5.30%	-0.10%
6-Month	2.49%	5.44%	5.43%	-0.01%
2-Year	2.96%	4.41%	4.90%	0.49%
5-Year	3.04%	3.76%	4.16%	0.40%
10-Year	3.02%	3.65%	3.84%	0.19%
30-Year	3.19%	3.86%	3.86%	0.00%

Yields by Sector and Maturity

Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	5.30%	5.22%	5.39%	-
6-Month	5.43%	5.35%	5.40%	-
2-Year	4.90%	4.85%	5.18%	2.91%
5-Year	4.16%	4.04%	4.83%	2.50%
10-Year	3.84%	4.15%	4.83%	2.78%
30-Year	3.86%	4.83%	5.06%	3.35%

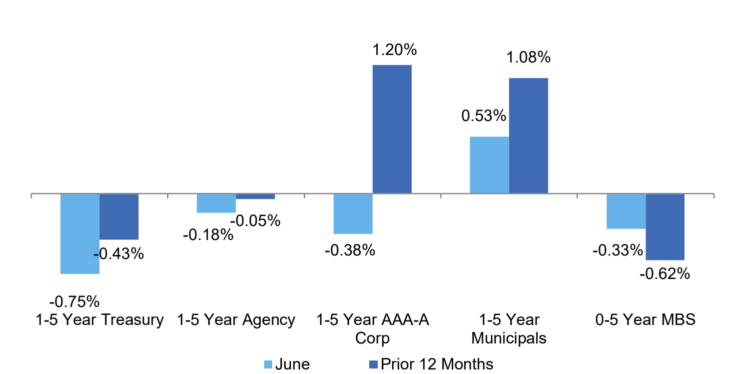
Spot Prices and Benchmark Rates

Index	Jun 30, 2022	May 31, 2023	Jun 30, 2023	Monthly Change
1-Month LIBOR	1.79%	5.19%	5.22%	0.03%
3-Month LIBOR	2.29%	5.52%	5.55%	0.03%
Effective Fed Funds Rate	1.58%	5.08%	5.08%	0.00%
Fed Funds Target Rate	1.75%	5.25%	5.25%	0.00%
Gold ($/oz)	$1,807	$1,964	$1,929	-$35
Crude Oil ($/Barrel)	$105.76	$68.09	$70.64	$2.55
U.S. Dollars per Euro	$1.05	$1.07	$1.09	$0.02

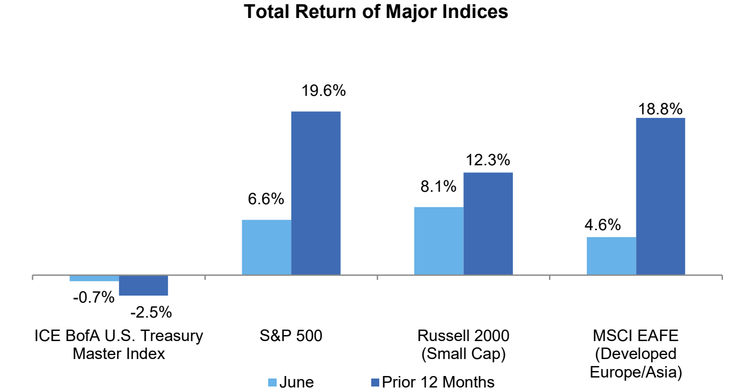
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
CPI YoY	13-Jun	May	4.00%	4.10%
FOMC Rate Decision	14-Jun	J-23	5.25%	5.25%
Retail Sales Advance MoM	15-Jun	May	0.30%	-0.20%
GDP Annualized QoQ	29-Jun	1Q T	2.00%	1.40%
U. of Mich. Consumer Sentiment	30-Jun	Jun F	64.4	63.9
PCE Core Deflator YoY	30-Jun	May	4.60%	4.70%
ISM Manufacturing	3-Jul	Jun	46.0	47.1

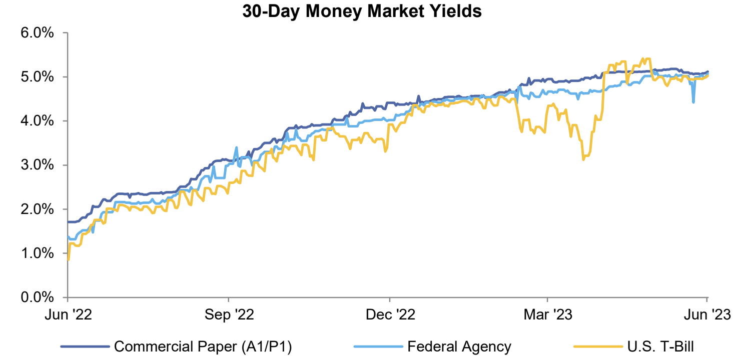
ICE BofA Fixed Income Index Returns



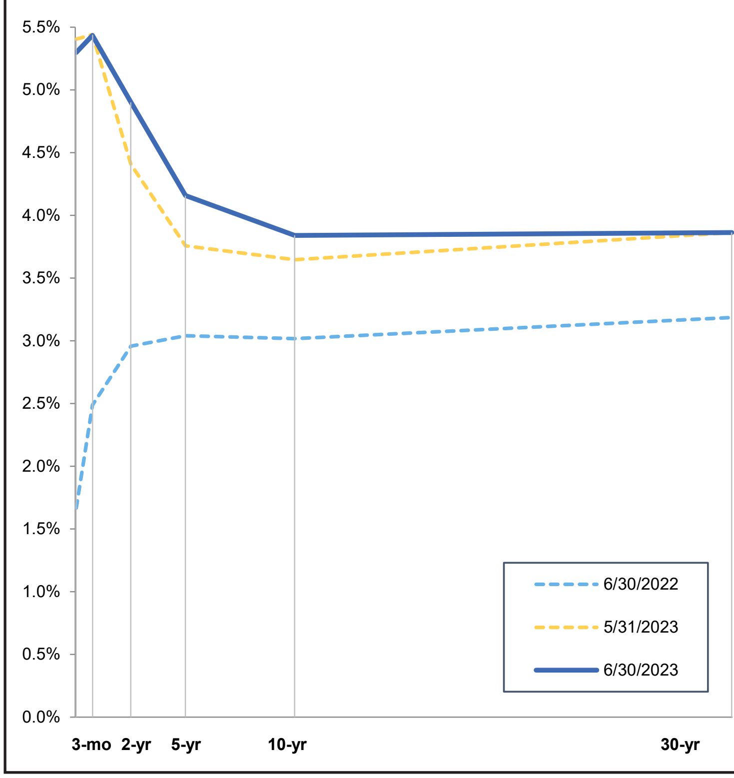
Total Return of Major Indices



30-Day Money Market Yields



U.S. Treasury Yield Curve



Source: Bloomberg. Data as of June 30, 2023, unless otherwise noted.

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