Monthly Market Review

Fixed Income | June 2023

pfm asset management

"POTUS Pens Debt Ceiling Papers."

Economic Highlights

► On Saturday June 3, two days ahead of the U.S. Treasury debt deadline, President Biden put pen to paper on the approval of the U.S. Treasury budget and the avoidance of a much talked about default. With debt ceiling talks in the rearview mirror, attention is now focused on the volume of debt issuance to come from the Treasury and how it will be absorbed in the markets.

► After a 25 basis point (bp) rate hike on May 3, which pushed the federal funds overnight target rate range to 5.00%-5.25%, markets are now pricing in one more 25 bp hike by the July meeting. Whether it is one, two or no hike, a pause is widely expected to follow as the Federal Reserve's (Fed) 'higher for longer' stance takes hold.

► Consumer prices (CPI) climbed 0.4% month-over-month in April and 4.9% year-over-year — marking the first-time annual inflation has landed below 5% in two years. The index for shelter was the largest contributor to the monthly increase, followed by increases for used cars and trucks and gasoline, with the increase in the gasoline index more than offsetting declines in other energy components.

► Once again, the absolute strength and resiliency of the American labor market was evident as the May employment report revealed job creation of 339,000 for the month, well exceeding both expectations of 195,000 and the April increase of 239,000. Employment continued to trend up in professional and business services, healthcare, leisure and hospitality, and social assistance. Idiosyncrasies in data-compiling methodologies were highlighted as the unemployment rate actually ticked higher to 3.7% from 3.4% one month prior.

► Retail trade sales were up 0.4% in April following the lackluster March release of -1.1%. Non-store retailers were up 8% from last year, while food services and drinking establishments were up 9.4% from April 2022.

► In the housing market, mortgage rates surged past 7% at the end of May, touching the high-end of their recent 12-month range. As a result, demand for home purchases and refinancing declined, although tight inventory continues to keep pressure on prices.

► The U.S. service sector expanded in April, restrained by the weakest pace of business activity in nearly three years. In manufacturing, the latest ISM report indicated a contraction for a seventh consecutive month.

Bond Markets

► U.S. Treasury yields moved higher across all tenors in May, led by one-year maturities increasing 43 bps over the month as markets repriced on 'higher for longer' expectations.

► Benchmark U.S. Treasuries for 3-month, 5-year, and 10-year maturities finished the month at 5.39%, 3.75%, and 3.64%, increasing 36, 27, and 22 bps, respectively.

► As a result, only the shortest duration U.S. Treasury indices generated positive total returns in May as higher income helped offset negative price effects. The ICE BofA 3-month, 5-year, and 10-year U.S. Treasury indices returned 0.39%, -0.99%, and -1.46%, respectively.

Equity Markets

► Equity markets were carried by the notable rally in the technology space, as artificial intelligence buzz catapulted valuations. For the month, the Dow Jones Industrial average declined 3.2%, and the S&P 500 Index notched a 0.4% gain, while the Nasdaq soared on the tech rally, up 5.9% for the month.

► The U.S. dollar Index (DXY) rebounded 2.6% during the month.

PFMAM Strategy Recap

► On the recent back-up in yields, we have begun to extend portfolio durations closer to their benchmarks over the past several weeks. While U.S. Treasury yields are not at February highs, they are now trading towards the higher end of their year-to-date ranges. We will likely continue to use recently higher yields to extend durations while maintaining a marginally defensive bias as the curve remains near historically extreme levels of inversion.

► The recent U.S. Treasury debt ceiling agreement allowed us to begin participating in upcoming new issuance with no maturity restrictions.

► Investment-grade (IG) corporate spreads ended the month modestly tighter after significant retracement from their mid-March wides. Spreads between financial and industrial sectors remain wide on a historical basis as lingering effects from banking concerns remain. As IG corporate spreads remain modestly elevated over a three-year timeframe, we will likely maintain current exposure and continue to actively participate in attractive new issues.

► AAA-rated asset-backed security (ABS) spreads were generally unchanged over the month but remain elevated relative to the recent tightening experienced in IG corporates. As a result, we view this divergence as an attractive opportunity to add to ABS at spread levels near their multi-year wides.

► The mortgage-backed security (MBS) sector rebounded in May, as most collateral types and coupon structures generated positive excess returns. With 30-year mortgage rates north of 7%, prepayments will likely remain depressed, and security duration extensions could persist. However, given the broad sell-off of the sector following notable underperformance in April, we continue to look for select opportunities to add to the sector.

U.S. Treasury Yields

Duration	May 31, 2022	Apr 30, 2023	May 31, 2023	Monthly Change
3-Month	1.06%	5.06%	5.40%	0.34%
6-Month	1.57%	5.02%	5.44%	0.42%
2-Year	2.56%	4.01%	4.41%	0.40%
5-Year	2.82%	3.49%	3.76%	0.27%
10-Year	2.85%	3.43%	3.65%	0.22%
30-Year	3.05%	3.68%	3.86%	0.18%

Yields by Sector and Maturity

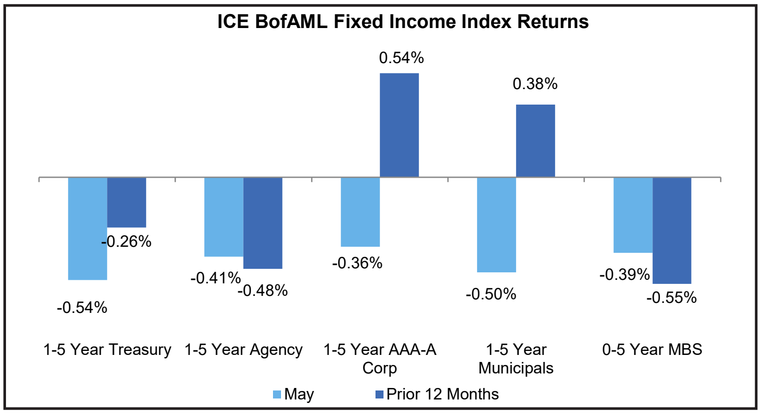
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	5.40%	5.25%	5.19%	-
6-Month	5.44%	5.31%	5.14%	-
2-Year	4.41%	4.54%	4.82%	3.05%
5-Year	3.76%	3.89%	4.55%	2.61%
10-Year	3.65%	3.94%	4.69%	2.88%
30-Year	3.86%	4.28%	5.14%	3.45%

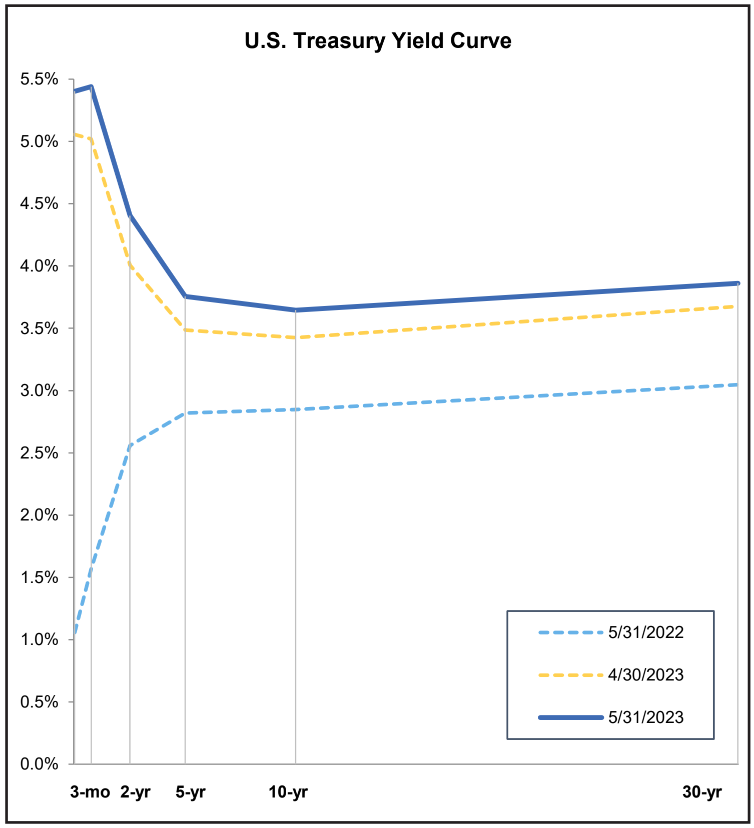
Spot Prices and Benchmark Rates

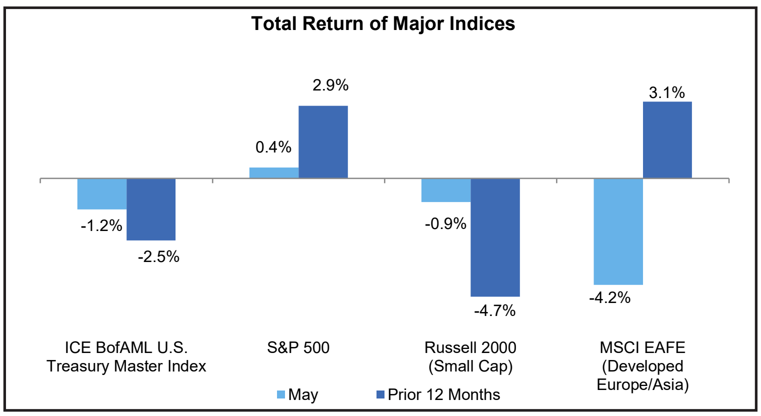
Index	May 31, 2022	Apr 30, 2023	May 31, 2023	Monthly Change
1-Month LIBOR	1.12%	5.06%	5.19%	0.13%
3-Month LIBOR	1.61%	5.30%	5.52%	0.22%
Effective Fed Funds Rate	0.83%	4.83%	5.08%	0.25%
Fed Funds Target Rate	1.00%	5.00%	5.25%	0.25%
Gold ($/oz)	$1,843	$1,999	$1,964	-$35
Crude Oil ($/Barrel)	$114.67	$76.78	$68.09	-$8.69
U.S. Dollars per Euro	$1.07	$1.10	$1.07	-$0.03

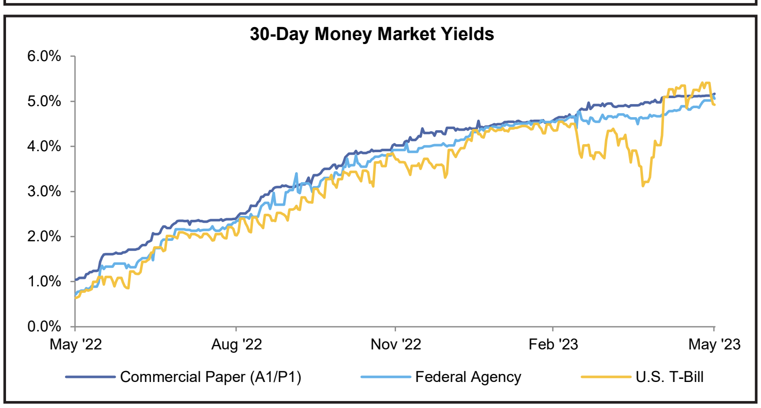
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
CPI YoY	10-May	Apr	4.90%	5.00%
Retail Sales Advance MoM	16-May	Apr	0.40%	0.80%
GDP Annualized QoQ	25-May	1Q S	1.30%	1.10%
U. of Mich. Consumer Sentiment	26-May	May F	59.2	58
ISM Manufacturing	1-Jun	May	46.9	47
Change in Nonfarm Payrolls	2-Jun	May	339K	195K
Unemployment Rate	2-Jun	May F	3.70%	3.50%









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

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