Monthly Market Review

Fixed Income | March 2023

pfm asset management

"What a long, strange trip it's been."

Economic Highlights

► The markets are dealing with a new challenge: heightened volatility and a less certain outlook as a result of the announcement of two large bank failures and the takeover of a third. The unique characteristics of one bank – Silicon Valley Bank – led to liquidity challenges, which resulted in it being shut down and taken over by the Federal Deposit Insurance Corporation (FDIC) in what became the second-largest bank failure in U.S. history. The closure of Signature Bank, New York, also happened over that same weekend.

► To quell possible contagion, the U.S. Treasury, Federal Reserve (Fed), and FDIC jointly announced two key actions: (1) protecting all depositors at both banks, including uninsured deposits over the current FDIC's $250,000 insurance limit, and (2) creation of a new "Bank Term Funding Program" designed to help ensure all banks have the liquidity to meet the needs of all their depositors.

► As expected, the Fed raised rates by 25 basis points (bps) on February 1. Then, they raised rates another 25 bps on March 22, despite the market uncertainty. The short-term fed funds rate is now at a new target range of 4.75% to 5.00%. The Fed's March updated Summary of Economic Projections were little changed from December. The fed funds rate is expected to end the year around 5.1%, while the projections for gross domestic product (GDP) and the unemployment rate were lowered 0.1% each to 0.4% and 4.5%, respectively.

► Employers added 311,000 jobs in February, above expectations. The labor market remains strong, with continued wage gains and large numbers of job openings.

► Year-over-year inflation (CPI) eased for the eighth month straight in February to 6.0%, compared to 6.4% in January. For the month, the price index for shelter was the largest contributor, accounting for over 70% of the overall increase, with the indices for food, recreation and transportation also contributing.

► After a strong 3.2% jump in January, retail sales fell -0.4% in February. Spending on general merchandise, health and personal care, and grocery stores rose, but were offset by declines in spending on autos, gasoline and appliances. Economic activity in the manufacturing sector remained in contraction territory, while service sector activity continued to show moderate expansion.

► On the housing front, home sales and housing starts both surprised to the upside. Lower mortgage rates resulting from the sharp decline in interest rates in March will lend some support to the sector, but banks are likely to tighten lending standards.

Bond Markets

► The 2-Year U.S. Treasury yield broke through its 2022 high, reaching a peak of 5.07% in early March. But, in a classic "flight-to-quality," yields plummeted, falling by more than 100 bps in the biggest 3-day slide since 1987.

► The benchmark 3-month, 2-year, and 10-year U.S. Treasury yields ended February at 4.77%, 4.82%, and 3.92%, respectively, but as of March 23 stood at 4.60%, 3.85%, and 3.42%. As shorter rates peaked, the 2- and 10-year spread reached -108 bps – the largest inversion in over 40 years.

► Fixed income U.S. Treasury index total returns broadly retreated in February across all tenors greater than one year. The ICE BofA 6-month Treasury index generated a positive return of 0.29%, while the 2-, 5-, and 10-year Treasury indices returned -0.88%, -2.35% and -3.10%, respectively. Month-to-date returns in March have turned strongly positive as a result of lower rates.

Equity Markets

► Stocks sold off in February after strength in jobs and concerns over stubbornly high inflation sparked a rise in Treasury yields. For the month, the Dow Jones Industrials shed 3.9%, while the S&P 500 index slid 2.5%, and the Nasdaq slipped 1.0%. Despite much volatility in March, month-to-date returns were muted, with the Nasdaq up about 2% through March 22.

► After four consecutive months of decline, the U.S. dollar index (DXY) advanced 2.7% higher in February, but reversed those gains in March.

PFMAM Strategy Recap

► The economic outlook has turned more cloudy. The Fed remains committed to fighting inflation but has also acknowledged the negative shock from the issues in the banking sector. Given the recent steep retreat in yields, we will likely maintain our modest defensive duration bias relative to benchmarks. We will continue to regularly reassess that positioning, with a renewed focus on the longer-term trajectory of our economic outlook.

► Investment-grade (IG) corporate spreads widened sharply in March, but the broad widening was somewhat short-lived. We are maintaining our current corporate positions, but given such a volatile environment for the credit markets, we are taking a cautious approach, especially in financials.

► Spreads on federal agencies and supranationals also widened, creating new investment opportunities, but bid/ask spreads remain wider than normal.

► Tighter credit conditions are usually accompanied by weaker credit fundamentals for consumers and businesses. We continue to closely monitor the performance of collateral-backing asset-backed securities (ABS), but remain comfortable with the structure and security of current holdings.

► Short-term yields have followed the Fed rate increases higher, but the money market yield curve has flattened as expectations for future rate hikes have moderated.

U.S. Treasury Yields

Duration	Feb 28, 2022	Jan 31, 2023	Feb 28, 2023	Monthly Change
3-Month	0.31%	4.67%	4.81%	0.14%
6-Month	0.64%	4.83%	5.15%	0.32%
2-Year	1.43%	4.20%	4.82%	0.62%
5-Year	1.72%	3.62%	4.18%	0.56%
10-Year	1.83%	3.51%	3.92%	0.41%
30-Year	2.16%	3.63%	3.92%	0.29%

Yields by Sector and Maturity

Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	4.81%	4.80%	5.17%	-
6-Month	5.15%	5.08%	5.17%	-
2-Year	4.82%	4.93%	5.09%	2.86%
5-Year	4.18%	4.43%	4.91%	2.65%
10-Year	3.92%	4.08%	4.97%	3.05%
30-Year	3.92%	3.63%	5.20%	3.61%

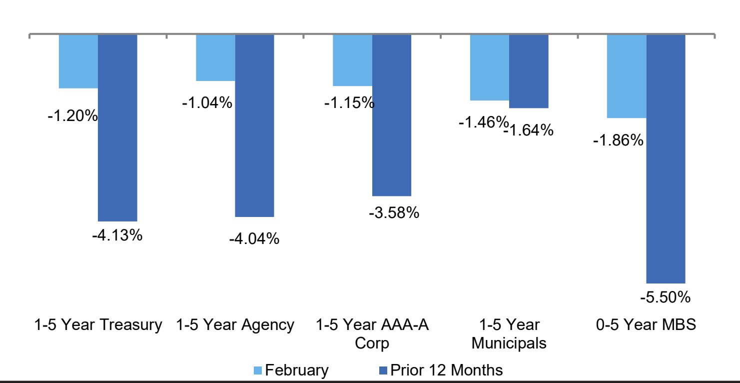
Spot Prices and Benchmark Rates

Index	Feb 28, 2022	Jan 31, 2023	Feb 28, 2023	Monthly Change
1-Month LIBOR	0.24%	4.57%	4.67%	0.10%
3-Month LIBOR	0.50%	4.81%	4.97%	0.16%
Effective Fed Funds Rate	0.08%	4.33%	4.57%	0.24%
Fed Funds Target Rate	0.25%	4.50%	4.75%	0.25%
Gold ($/oz)	$1,901	$1,930	$1,837	-$93
Crude Oil ($/Barrel)	$95.72	$78.87	$77.05	-$1.82
U.S. Dollars per Euro	$1.12	$1.09	$1.06	-$0.03

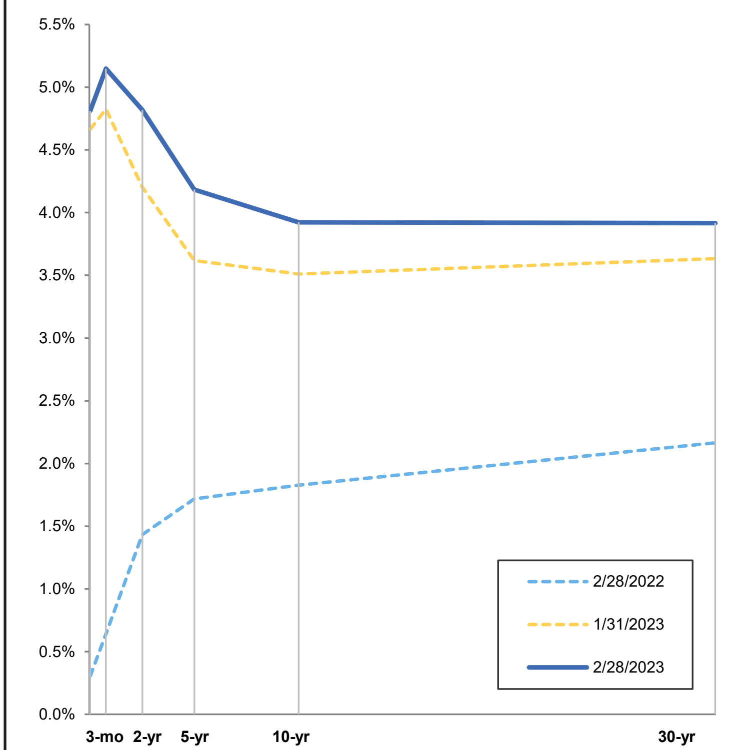
Key Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
CPI YoY	14-Feb	Jan	6.40%	6.20%
Retail Sales Advance MoM	15-Feb	Jan	3.00%	2.00%
GDP Annualized QoQ	23-Feb	4Q S	2.70%	2.90%
New Home Sales MoM	24-Feb	Jan	7.20%	0.70%
U. of Mich. Consumer Sentiment	24-Feb	Feb F	67	66.4
PCE Core Deflator YoY	24-Feb	Jan	4.70%	4.30%
ISM Manufacturing	1-Mar	Feb	47.7	48

ICE BofAML Fixed Income Index Returns

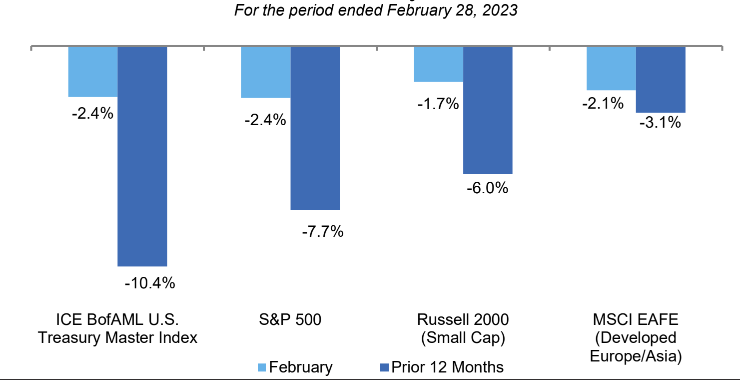


U.S. Treasury Yield Curve

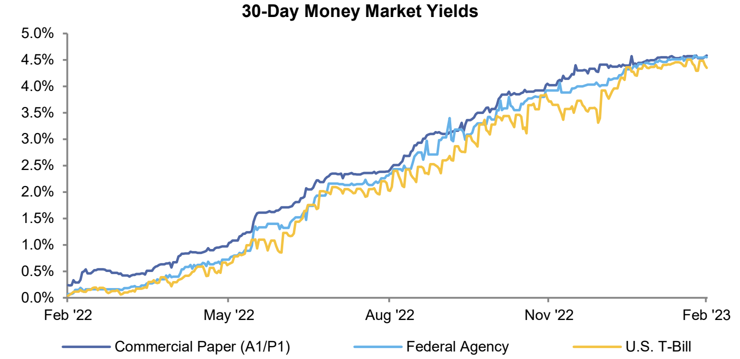


Total Return of Major Indices

For the period ended February 28, 2023



30-Day Money Market Yields



Source: Bloomberg. Data as of February 28, 2023, unless otherwise noted.

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