Monthly Market Review

Fixed Income | August 2024

pfm asset management

Month-over-Month Moderation More than Meaningful

Economic Highlights

► At the July Federal Open Market Committee (FOMC) meeting, the Federal Reserve (Fed) left the federal funds target rate unchanged at 5.25% to 5.50%, which was in line with expectations. However, the Committee's accompanying statement highlighted a transition to a more balanced consideration of both parts of its dual mandate of maximum employment and price stability. Furthermore, Fed Chair Powell hinted that a rate cut could be on the table at the September meeting.

► June inflation readings continued to make gradual progress towards the Fed's 2% target. Both the year-over-year change in the Consumer Price Index (CPI) and Personal Consumption Expenditures Index (PCE) slowed to 3.0% and 2.5%, respectively. The improved inflation picture was highlighted by Chair Powell at the latest FOMC meeting. He noted that recent readings have added to the Fed's confidence that inflation is moving sustainably towards 2%.

► The advance reading of second quarter gross domestic product (GDP) came in notably above expectations at 2.8%. Growth was largely supported by personal consumption following a rebound in goods spending and nonresidential fixed investment led by equipment spending. Inventory growth also added about 0.8% but that tends to be reversed in future quarters.

► June retail sales were negatively impacted by a two-week cyber-attack on auto dealership software that muted sales activity. However, expectations are for a rebound next month, with sales delayed rather than derailed. More broadly, retail sales (ex-autos) were strong, led by a 1.9% increase in non-store retailers.

► The July jobs report missed expectations badly. Nonfarm payrolls showed just 114,000 net new jobs versus estimates of 175,000. The unemployment rate also ticked higher to 4.3% underscoring continuing moderation of the labor market from historically tight levels. Combined with other weakening measures of employment, such as a rise in weekly jobless claims, the market response was swift and decidedly downbeat. Immediately after the report, stocks went into a two-day tailspin and bond yields plunged.

Bond Markets

► U.S. Treasury yields between 2- and 10-years finished July down approximately 35 to 50 basis points (bps) as markets digested broad economic cooling and prepared for the beginning of the Fed rate cut cycle.

► Yields on benchmark 2-, 5-, and 10-year U.S. Treasuries ended the month at 4.26%, 3.91%, and 4.03%, respectively, representing changes of -50, -47, and -37 bps for the month, respectively.

► Fixed income total returns were firmly positive on the notable rate rally in July. The ICE BofA 2-, 5-, and 10-year U.S. Treasury indices returned 1.15%, 2.16%, and 2.88%, respectively.

► *Time of writing update: U.S. Treasury yields rallied significantly in response to the August 2 labor market report as markets fully priced multiple rate cuts through the balance of 2024. As of August 6, the 2-year U.S. Treasury stood at 4.01%.*

Equity Markets

► Equity markets reflected the recent sentiment shift on increased uncertainty around the pace of Fed cuts as the S&P 500 Index declined over 8% from the mid-July all-time highs through the first three days of August. Nevertheless, the headline index remained up nearly 10% for the year.

► Technology sectors were hit even worse, with the NASDAQ falling 12.5% from its highs and now trailing the broader S&P 500 for the year.

► International equities (as measured by MSCI ACWI ex-U.S. Net Index) fell by a similar amount and trail U.S. equities by a wide margin in 2024.

PFMAM Strategy Recap

► While the pace and magnitude of future Fed cuts is even more uncertain following the July labor report, we have held the view for some time that rates have peaked and Fed rate cuts are coming before the end of the year. Given that view, we have held portfolio durations near 100% of benchmarks for several months.

► Spreads on federal agencies and supranationals remain near multi-year tights. Issuance is expected to remain quiet going into the summer, and we expect further reductions in allocations in favor of other sectors.

► Investment-grade (IG) corporate bonds grinded out a modestly positive excess return relative to U.S. Treasuries in July as income in the sector more than offset slight spread widening. Yield spreads remain on the tighter side through July and valuations appear expensive, but demand has been robust. As a result, we plan to continue to trim on the margins while taking advantage of attractively priced new issues.

► Asset-backed securities (ABS) generated flat excess returns for the month. Issuance has been strong, but expectations are for new deals to taper off as the election and year-end approach. We will likely maintain allocations while allowing principal paydowns to provide modest reinvestment opportunities.

► Mortgage-backed securities (MBS) and agency-backed commercial MBS (CMBS) were one of the best performing high-quality IG sectors in July. Spreads in many corners of the mortgage-related market narrowed in July and approached 12-month narrows. Lower rates are a net positive for the MBS sector.

U.S. Treasury Yields

Maturity	Jul 31, 2023	Jun 30, 2024	Jul 31, 2024	Monthly Change
3-Month	5.42%	5.36%	5.29%	-0.07%
6-Month	5.47%	5.33%	5.09%	-0.24%
2-Year	4.88%	4.76%	4.26%	-0.50%
5-Year	4.18%	4.38%	3.91%	-0.47%
10-Year	3.96%	4.40%	4.03%	-0.37%
30-Year	4.01%	4.56%	4.30%	-0.26%

Yields by Sector and Maturity

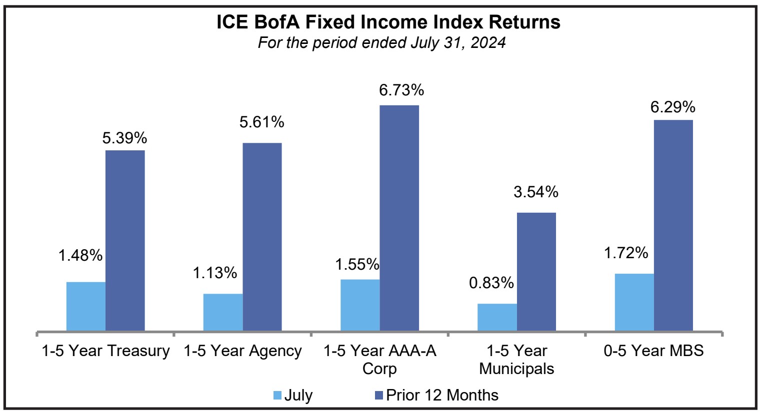
Maturity	U.S. Treasury	Federal Agency	Corporates-AA-A Industrials	AAA Municipals
3-Month	5.29%	5.30%	5.28%	-
6-Month	5.09%	5.09%	5.28%	-
2-Year	4.26%	4.27%	4.72%	2.87%
5-Year	3.91%	3.92%	4.57%	2.68%
10-Year	4.03%	4.09%	4.85%	2.67%
30-Year	4.30%	-	5.37%	3.58%

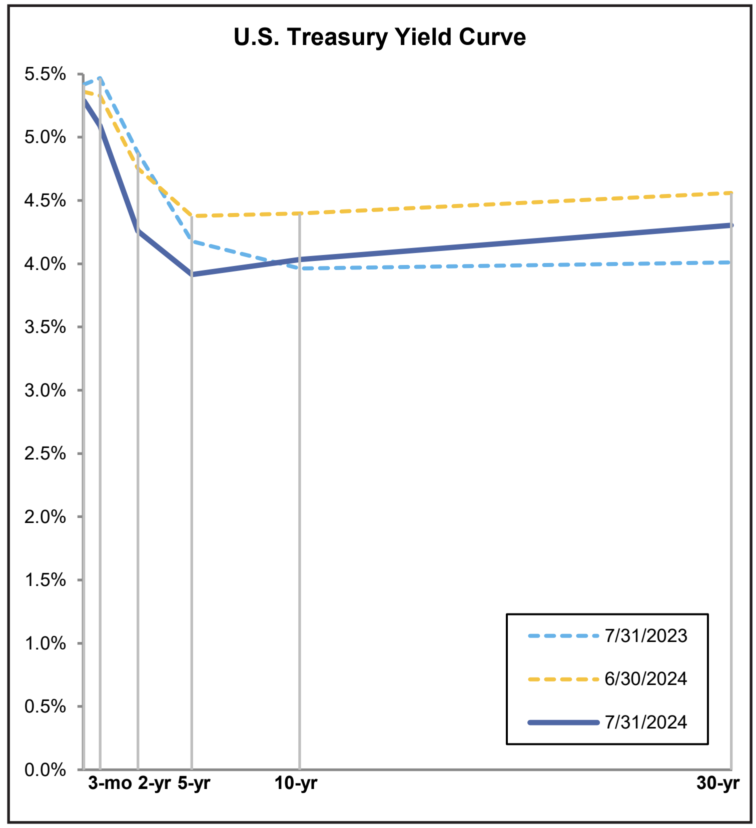
Spot Prices and Benchmark Rates

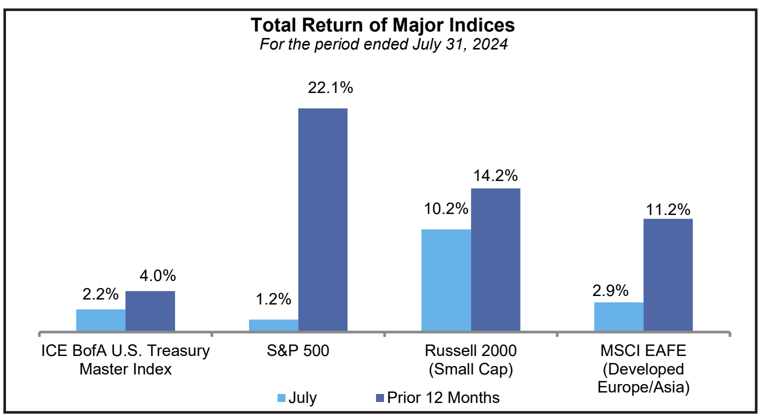
Index	Jul 31, 2023	Jun 30, 2024	Jul 31, 2024	Monthly Change
1-Month LIBOR	5.43%	5.45%	5.46%	0.01%
3-Month LIBOR	5.63%	5.59%	5.50%	-0.09%
Effective Fed Funds Rate	5.33%	5.33%	5.33%	0.00%
Fed Funds Target Rate	5.50%	5.50%	5.50%	0.00%
Gold ($/oz)	$1,971	$2,340	$2,427	$87
Crude Oil ($/Barrel)	$81.80	$81.54	$77.91	-$3.63
U.S. Dollars per Euro	$1.10	$1.07	$1.08	$0.01

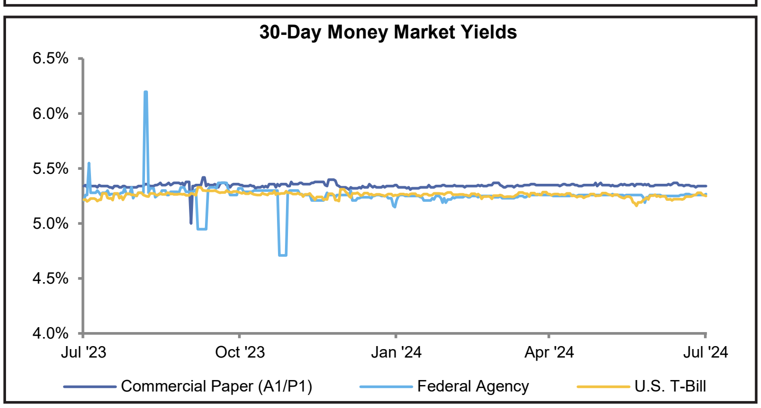
Economic Indicators

Indicator	Release Date	Period	Actual	"Survey (Median)"
CPI YoY	11-Jul	Jun	3.00%	3.10%
Retail Sales Advance MoM	16-Jul	Jun	0.00%	-0.30%
Existing Home Sales MoM	23-Jul	Jun	-5.40%	-3.20%
GDP Annualized QoQ	25-Jul	2Q A	2.80%	2.00%
U. of Mich. Consumer Sentiment	26-Jul	Jul F	66.4	66.5
PCE YoY	26-Jul	Jun	2.50%	2.50%
FOMC Rate Decision	31-Jul	July	5.50%	5.50%









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

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