# Monthly Market Review

**Fixed Income | September 2024**

pfm asset management

***Pruners, Shears, or Chainsaw…A Cut is on the Way***

## Economic Highlights

► Minutes from the July Federal Open Market Committee (FOMC) meeting showed that Federal Reserve (Fed) governors expressed more confidence in easing inflation and noted that labor supply and demand "continued to come into better balance." The Fed concluded that conditions could have supported a case "for reducing the target range 25 basis points at this meeting." A rate cut of 25-50 basis points (bps) is now widely expected at the September 17-18 meeting.

► Chair Powell's remarks at the annual Jackson Hole Symposium effectively cemented expectations for a rate cut at the September meeting. Powell said, "the time has come for policy to adjust." Although he did not clarify the size, he stated that "the timing and pace of rate cuts will depend on incoming data, the evolving outlook, and the balance of risks."

► July inflation readings maintained an encouraging trajectory towards the Fed's 2% target, with the Core Personal Consumption Expenditure (PCE) Price Index coming in at 2.6% year-over-year, in line with recent months and holding near a three-year low.

► The second estimate of second quarter GDP was revised to 3.0%, an upside surprise chalked up to U.S. economic resiliency. Much of the increase came from higher-than-expected services consumption, with the consumer spending contribution coming in at a strong 2.9%. This was partially offset by downward revisions to business investment and government spending.

► The Bureau of Labor Statistics (BLS) announced its preliminary estimate for the upcoming annual benchmark revision to the establishment survey employment series (commonly known as "nonfarm payrolls"). It estimates that the total number of jobs added during the 12-month period ended March 2024 will be revised lower by 818,000 jobs, resulting in 2.1 million jobs being added during the period instead of the original estimate of 2.9 million. While revisions based on more complete data are common, this represented the largest downward revision since 2009, further reinforcing that labor markets are softening.

► Nonfarm payrolls for August came in at 142,000, which was better than July's print but still below expectations. Meanwhile, the unemployment rate ticked down to 4.2%. It now appears that a Fed rate cut in September is a formality, although there is still significant uncertainty regarding the size.

## Bond Markets

► U.S. Treasury yields fell in August as markets reacted to weaker labor market reports and updated messaging regarding the imminency of the Fed's rate cut cycle.

► Yields on benchmark 2-, 5-, and 10-year U.S. Treasuries ended the month at 3.92%, 3.70%, and 3.90%, respectively, representing changes of -34, -21, and -13 bps for the month, respectively.

► Fixed income total returns were quite strong for a second consecutive month as yields continued to nosedive. The ICE BofA 2-, 5-, and 10-year U.S. Treasury indices returned 0.89%, 1.16%, and 1.38%, respectively, for the month.

## Equity Markets

► Global equity markets sold off in early August, largely on technical trades related to USD-JPY currency factors. However, strong second quarter earnings and rate-cut expectations helped spur a reversal that more than offset early-month declines. The S&P 500 Index ended the month up 2.4% and over 19% on the year.

► The Dow Jones Industrial Average was up 2.0% on the month, reaching a new all-time high, while the NASDAQ Index was up 0.7%. Year-to-date returns are 11.7% and 18.6%, respectively.

► International equities (as measured by the MSCI ACWI ex U.S. Net Index) rose by 2.8% on the month and are up 11.2% for the year.

## PFMAM Strategy Recap

► Though there has been more clarity regarding the timing of the first Fed rate cut, the pace and magnitude of future Fed cuts remain uncertain. As a result, we will continue to maintain portfolio durations near 100% of benchmarks.

► The U.S. Treasury yield curve has remained inverted for a record amount of time. Historically, as markets start pricing in a change in monetary policy (e.g. cutting the overnight target rate), the curve steepens. As a result, we expect the curve to dis-invert and prefer a modestly "bulleted" curve positioning.

► Spreads on federal agencies and supranationals remain unchanged near multi-year tights and are not expected to change in the near term. We expect to maintain low allocations in favor of other sectors.

► Investment-grade (IG) corporate bonds posted modestly positive excess returns relative to U.S. Treasuries in August as incremental income helped offset modest spread widening effects on prices. Spread widening, caused by a volatility spike in early August, presented some unexpected idiosyncratic buying opportunities in the new issuance and secondary markets.

► Asset-backed securities (ABS) eked out muted excess returns as spreads remained elevated relative to the corporate sector. We will likely maintain allocations while allowing principal paydowns to provide modest reinvestment opportunities.

► Mortgage-backed securities (MBS) and agency-backed commercial MBS (CMBS) performed well in August despite the spike in volatility. As rates have fallen notably over the past several weeks, the housing market has gained a tailwind. Therefore, we will likely maintain allocations to mortgage sectors.

► Credit spreads on the short end of the curve widened slightly toward the end of the month. The money market yield curve in general remains inverted as the market continues to price in multiple Fed rate cuts.

## U.S. Treasury Yields

| Maturity | Aug 31, 2023 | Jul 31, 2024 | Aug 31, 2024 | Monthly Change |
|---|---|---|---|---|
| 3-Month | 5.45% | 5.29% | 5.12% | -0.17% |
| 6-Month | 5.51% | 5.09% | 4.86% | -0.23% |
| 2-Year | 4.87% | 4.26% | 3.92% | -0.34% |
| 5-Year | 4.26% | 3.91% | 3.70% | -0.21% |
| 10-Year | 4.11% | 4.03% | 3.90% | -0.13% |
| 30-Year | 4.21% | 4.30% | 4.20% | -0.10% |

## Yields by Sector and Maturity

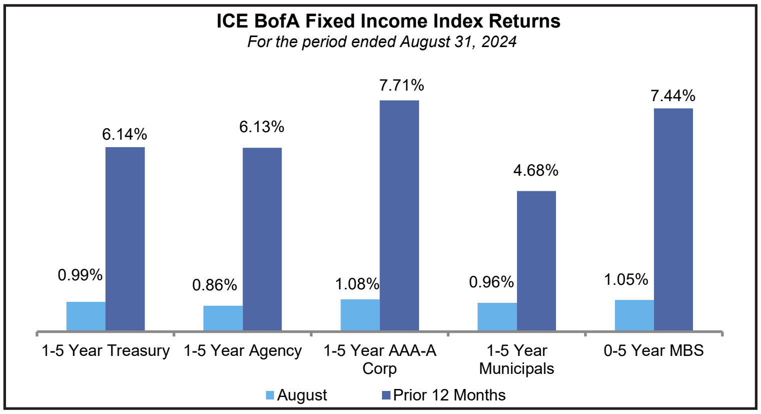
| Maturity | U.S. Treasury | Federal Agency | Corporates-AA-A Industrials | AAA Municipals |
|---|---|---|---|---|
| 3-Month | 5.12% | 5.13% | 5.00% | - |
| 6-Month | 4.86% | 4.86% | 5.00% | - |
| 2-Year | 3.92% | 3.93% | 4.40% | 2.53% |
| 5-Year | 3.70% | 3.71% | 4.35% | 2.46% |
| 10-Year | 3.90% | 3.96% | 4.70% | 2.62% |
| 30-Year | 4.20% | - | 5.24% | 3.50% |

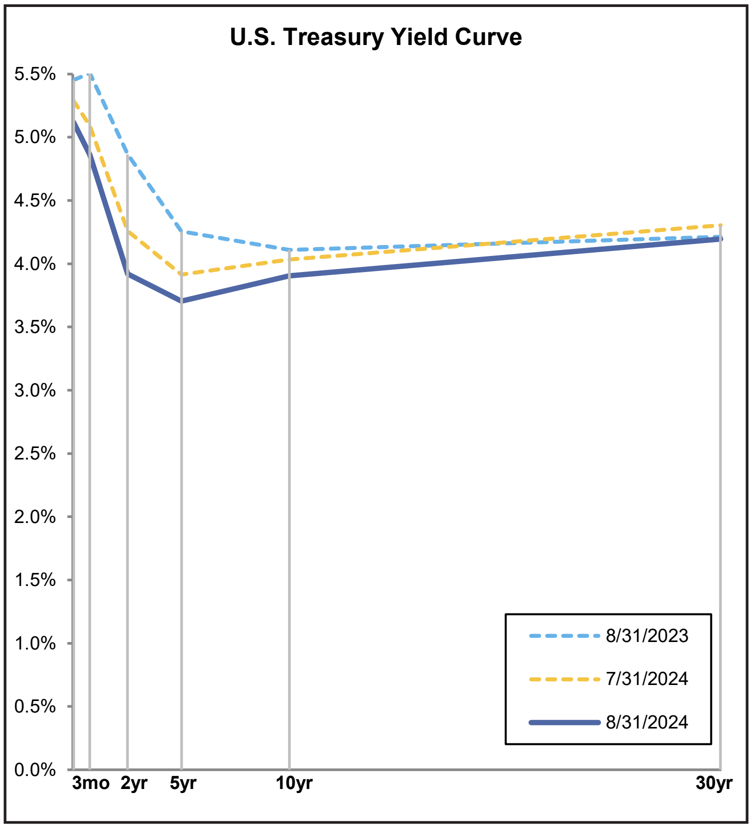
## Spot Prices and Benchmark Rates

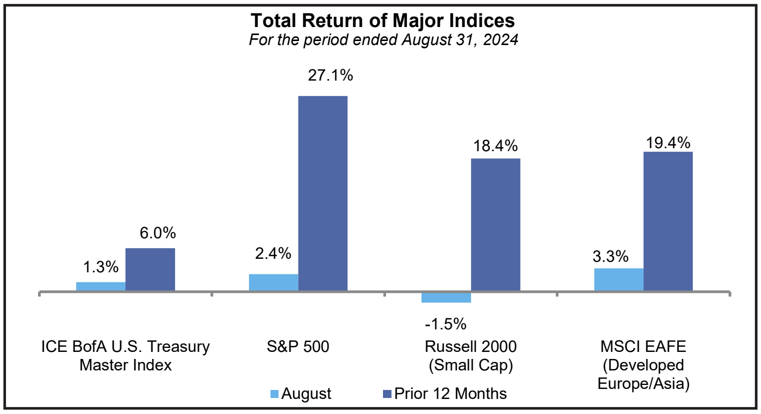
| Index | Aug 31, 2023 | Jul 31, 2024 | Aug 31, 2024 | Monthly Change |
|---|---|---|---|---|
| 1-Month LIBOR | 5.44% | 5.46% | 5.31% | -0.15% |
| 3-Month LIBOR | 5.66% | 5.50% | 5.28% | -0.22% |
| Effective Fed Funds Rate | 5.33% | 5.33% | 5.33% | 0.00% |
| Fed Funds Target Rate | 5.50% | 5.50% | 5.50% | 0.00% |
| Gold ($/oz) | $1,947 | $2,427 | $2,505 | $78 |
| Crude Oil ($/Barrel) | $83.63 | $77.91 | $73.55 | -$4.36 |
| U.S. Dollars per Euro | $1.08 | $1.08 | $1.10 | $0.02 |

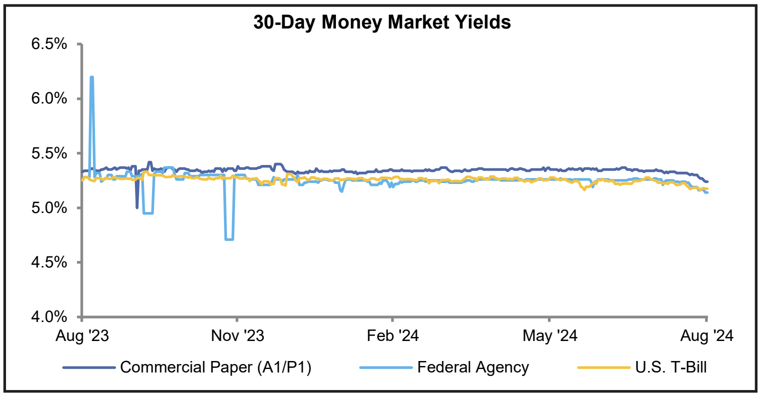
## Economic Indicators

| Indicator | Release Date | Period | Actual | "Survey (Median)" |
|---|---|---|---|---|
| CPI YoY | 14-Aug | Jul | 2.90% | 3.00% |
| Retail Sales Advance MoM | 15-Aug | Jul | 1.00% | 0.40% |
| Existing Home Sales MoM | 22-Aug | Jul | 1.30% | 1.30% |
| GDP Annualized QoQ | 29-Aug | 2Q S | 3.00% | 2.80% |
| U. of Mich. Consumer Sentiment | 30-Aug | Aug F | 67.9 | 68.1 |
| PCE YoY | 30-Aug | Jul | 2.60% | 2.70% |
| ISM Manufacturing | 3-Sep | Aug | 47.2 | 47.5 |




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

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