Monthly Market Review

Fixed Income | December 2021

pfm asset management

"It's beginning to look a lot like…"

Economic Highlights

► The emergence of the Omicron variant presents a risk to the economic recovery trajectory. So far, the Omicron variant has been reported in at least 25 U.S. states, with cases expected to rise during the holiday travel season.

► The consumer price index (CPI) rose to the highest level in nearly 40 years, reaching 6.8% for the 12 months ending November, up from 6.2% the prior month. There were notable price increases in gasoline, used cars and trucks, new vehicles, shelter costs and food. Excluding food and energy, the "core CPI" rose 4.9%. Elevated inflation seems likely to persist longer and at higher levels than initially expected. Although Federal Reserve (Fed) Chair Jerome Powell officially retired the categorization of inflation as "transitory," most economists expect inflation to moderate over the next year.

► Hiring appeared to slow as the U.S. economy added only 210,000 jobs in November, which was well below economists' expectations for 550,000 jobs. While this data is based on a survey of business establishments, the household survey showed gains of over 1.1 million in employment, with the unemployment rate falling to a current cycle low of 4.2%. In addition, there were improvements in the all-important labor force participation rate, wages and weekly hours worked.

► President Biden re-nominated Jerome Powell to serve as chair of the Fed to another four-year term, citing "steady and decisive leadership." Dr. Lael Brainard, a member of the Federal Reserve Board of Governors since 2014, was nominated to serve as vice chair. Randal Quarles, the current vice chair for supervision, announced he will retire by year-end, creating a vacancy for this important role overseeing the country's banking system.

► The Federal Reserve Open Market Committee meets in mid-December and is widely expected to increase the pace of tapering its asset purchases, which may now be completed by March 2022. This pulls forward the window for potential rate hikes. The market is pricing in two to three rate hikes in 2022 and another couple of hikes in 2023.

Bond Markets

► The U.S. Treasury yield curve flattened in November, as yields on shorter-term maturities (three years and under) rose modestly, while yields on maturities over three years declined. The 30-year Treasury yield fell to its lowest level since January.

► Given yield movements over the month, Treasury returns were a mixed bag, with shorter tenors declining and longer tenors advancing. 1-, 5-, and 10-year Treasury indices returned -0.05%, +0.28%, and +1.29%, respectively in November.

► Investment-grade (IG) corporate yield spreads widened in November in response to the emergence of the Omicron variant, general market volatility and uncertainty around the pace of potential Fed rate hikes.

Equity Markets

► The looming removal of monetary policy accommodation amid a resurgence in COVID-19 cases weighed on investor sentiment and led to a post-Thanksgiving selloff. Despite setting seven new record highs in the month, the S&P 500 ultimately posted a loss of -0.7%. The NASDAQ index advanced 0.3%, while the Dow Jones Industrial Average was hardest hit, falling 3.5%.

► U.S. Dollar Index (DXY) continued its second half ascent, appreciating 2% in November to its strongest level since July 2020 as inflation concerns solidified expectations for tighter Fed policy.

PFM Strategy Recap

► The U.S. economic recovery momentum ebbed and flowed alongside COVID-19 infection rates. Rising inflation remains a key investor focus as the made a hawkish pivot. Although rates have risen quite a bit already, outsized inflation readings, macroeconomic strength, and heightened rate volatility encouraged us to set a modestly defensive duration bias versus benchmarks.

► Most spread sectors experienced modest spread widening during month, coming off rock-bottom tight levels. After a strong positive impact over the past year, diversification away from U.S. Treasuries detracted from returns in November.

► For the first time in a while, federal agency yield spreads widened, albeit only a few basis points. But, weaker market liquidity limited swap opportunities. Spreads in the sector remain very tight with limited upside.

► IG corporate yield spreads increased, and by month-end were at or near 2021 wides. Spreads on IG corporates with maturities between one and three years led the charge wider, driven by increased volatility in front-end rates.

► Following the same pattern as IG corporates, yield spreads on AAA-rated asset-backed securities (ABS) moved modestly wider. Collateral performance remains strong.

► Mortgage-backed securities (MBS) spreads widened amid a modest pop in refinancing activity as 30-year Treasury yields fell over the month.

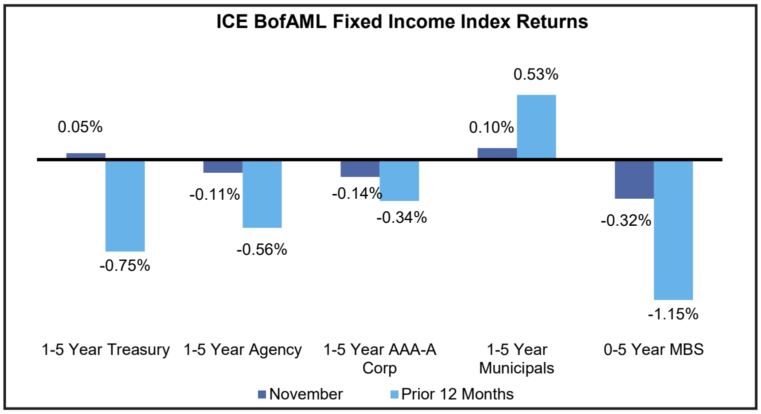
► Yields on longer money market securities (6-12 months) moved sharply higher and offer significant value versus overnight investments, which remain anchored near zero.

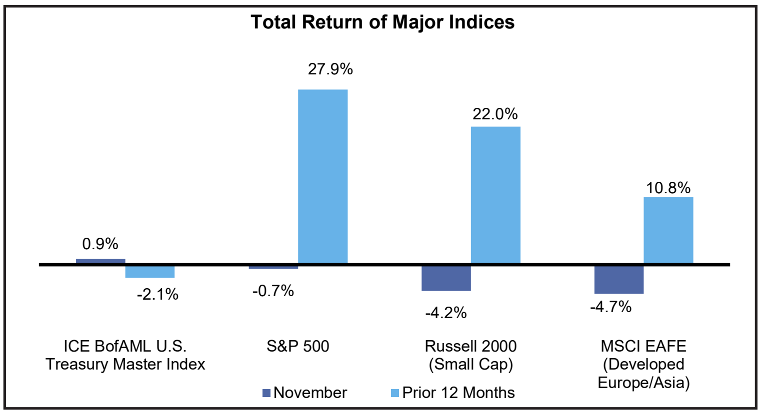
U.S. Treasury Yields				
Duration	Nov 30, 2020	Oct 31, 2021	Nov 30, 2021	Monthly Change
3-Month	0.08%	0.06%	0.05%	-0.01%
6-Month	0.09%	0.06%	0.10%	0.04%
2-Year	0.15%	0.50%	0.57%	0.07%
5-Year	0.36%	1.19%	1.16%	-0.03%
10-Year	0.84%	1.56%	1.45%	-0.11%
30-Year	1.57%	1.93%	1.79%	-0.14%

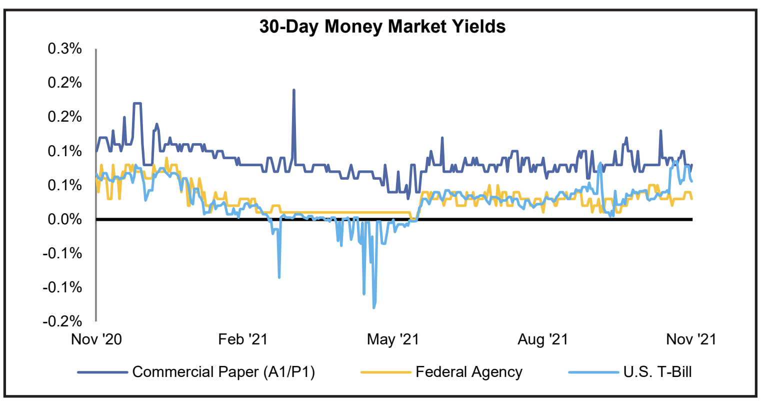
Yields by Sector and Maturity				
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	0.05%	0.03%	0.40%	--
6-Month	0.10%	0.07%	0.44%	--
2-Year	0.57%	0.59%	0.76%	0.19%
5-Year	1.16%	1.22%	1.54%	0.55%
10-Year	1.45%	1.60%	2.20%	1.25%
30-Year	1.79%	2.05%	2.80%	1.75%

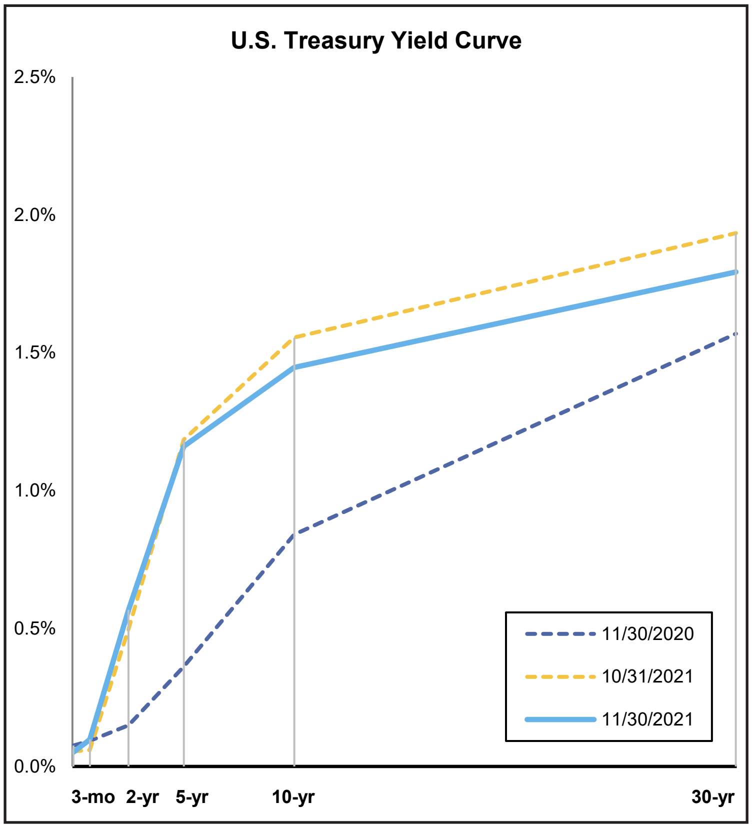
Spot Prices and Benchmark Rates				
Index	Nov 30, 2020	Oct 31, 2021	Nov 30, 2021	Monthly Change
1-Month LIBOR	0.15%	0.09%	0.09%	0.00%
3-Month LIBOR	0.23%	0.13%	0.17%	0.04%
Effective Fed Funds Rate	0.09%	0.07%	0.07%	0.00%
Fed Funds Target Rate	0.25%	0.25%	0.25%	0.00%
Gold ($/oz)	$1,776	$1,784	$1,774	-$10
Crude Oil ($/Barrel)	$45.34	$83.57	$66.18	-$17.39
U.S. Dollars per Euro	$1.19	$1.16	$1.13	-$0.03

Key Economic Indicators				
Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales Advance MoM	16-Nov	Oct	1.7%	0.7%
GDP Annualized QoQ	24-Nov	3Q S	2.1%	2.2%
PCE Core Deflator YoY	24-Nov	Oct	4.1%	4.1%
Consumer Confidence	30-Nov	Nov	109.5	110.9
ISM Manufacturing	1-Dec	Nov	61.1	61.2
Change in Nonfarm Payrolls	3-Dec	Nov	210k	550k
Unemployment Rate	3-Dec	Nov	4.2%	4.5%









Source: Bloomberg. Data as of November 30, 2021, unless otherwise noted.

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