Monthly Market Review

Fixed Income | June 2022

pfm asset management

"I'll see your 50 and raise you 75 (basis points)."

Economic Highlights

► Economic prospects have worsened as inflation pressures remain acute, COVID-19 lockdowns in China perpetuate supply challenges, consumer sentiment plunges, and rising interest rates push both bond and equity market prices lower.

► The Consumer Price Index (CPI) in the U.S. rose in shocking fashion in May, registering an 8.6% increase over the past year – a new 40-year high. Analysts had expected a decrease, indicating prices had peaked, but that was not the case.

► Inflation remained the most pressing concern for consumers, led by record-high gasoline prices, which reached an average of $4.67 a gallon in May and headed even higher in early June. But, inflation pressures went well beyond gasoline, as prices for chicken, fish, eggs, milk, and coffee have increased more than 10% over the past year. Costs of lodging, airfares, health insurance and laundry services were also up double digits.

► Despite worker shortages, the U.S. economy added 390,000 net new jobs in May, beating expectations, but the lowest number in a year. The unemployment rate held steady at 3.6%. The Challenger Report for May showed fewer job cuts overall, but sharp increases in layoffs in the Technology, Fintech, Construction and Automotive industries, which could indicate some moderation of labor market conditions ahead.

► Manufacturing activity advanced slightly in May as new orders increased, but the recent inventory overhang is now a headwind, especially in the retail sector.

► Minutes from the Federal Reserve's (Fed) May 3-4 policy meeting, released on May 25, indicated the central bank is likely to lift its benchmark interest rate, currently with a target range of 0.75% and 1%, by 50 basis points (bps) at its next two meetings in June and July. But, given the inflation backdrop, the market has begun to contemplate the need – and expectation – for a more aggressive 75 basis point hike at an upcoming meeting.

► The Fed kicked off its balance sheet reduction measures on June 1, allowing up to $30 billion worth of Treasury securities and $17.5 billion worth of agency debt and mortgage-backed securities (MBS) to roll off each month. After three months, the monthly caps will jump to $60 billion and $35 billion, respectively.

Bond Markets

► Treasury yields were mixed in May. After their rapid ascent over the first four months of the year, yields on 1-10 year maturities drifted modestly lower. But the bigger story was the sharp turn higher in yields in early June, accelerating after the release of the May CPI report. Increasing expectations of more aggressive Fed rate hikes are leading rates higher.

► Yields on benchmark 2- and 10-year Treasury notes finished May at 2.56% and 2.85%, respectively, but by June 10 were at 3.07% and 3.16%. Returns on bond market indices continue to be dragged further into negative territory in what is the worst start to a year in recent history.

► Despite a modest reprieve in May, the ICE BofA 2-, 5-, and 10-year Treasury indices have returned -2.5%, -6.4% and -10.6%, respectively, year-to-date (YTD).

Equity Markets

► Amid the uncertainty of global growth and tighter monetary policy, the S&P 500 and Dow Industrials indices ended May roughly flat after a month of volatility marked by major price action in both directions. However, in line with the recent trend of value over growth, the Nasdaq retreated 1.9% in May and is now trailing the S&P 500 by nearly 10% YTD. Like bonds, stocks indices turned sharply lower after the bad CPI report.

► International stocks, as measured by the MSCI ACWI ex-U.S. Index, ecked out a small 0.81% gain in May, but remain down double digits for the year.

PFMAM Strategy Recap

► As the Fed is widely expected to methodically raise rates at upcoming meetings through year end, we plan to maintain a defensive duration bias relative to benchmarks.

► Federal agency securities remain unattractive as spreads are narrow and issuance is light.

► Investment-grade (IG) corporate spreads ended May largely unchanged after briefly touching mid-March wides, underscoring continued uncercertainty in the credit markets. With spreads elevated, outside of clearer signs of a looming recession, we will likely continue to selectively add to high quality corporate allocations.

► Asset-backed security (ABS) spreads now stand at two-year wides. Current valuations are attractive and offer excess earnings potential relative to Treasuries.

► In the face of Fed balance sheet reductions, the MBS sector will likely remain under pressure and should be avoided.

► Short-term money market instruments, like commercial paper and bank CDs, now offer excellent yields, with limited interest rate risk.

U.S. Treasury Yields

Duration	May 31, 2021	Apr 30, 2022	May 31, 2022	Monthly Change
3-Month	0.01%	0.83%	1.06%	0.23%
6-Month	0.03%	1.41%	1.57%	0.16%
2-Year	0.14%	2.72%	2.56%	-0.16%
5-Year	0.80%	2.96%	2.82%	-0.14%
10-Year	1.60%	2.94%	2.85%	-0.09%
30-Year	2.28%	3.00%	3.05%	0.05%

Yields by Sector and Maturity

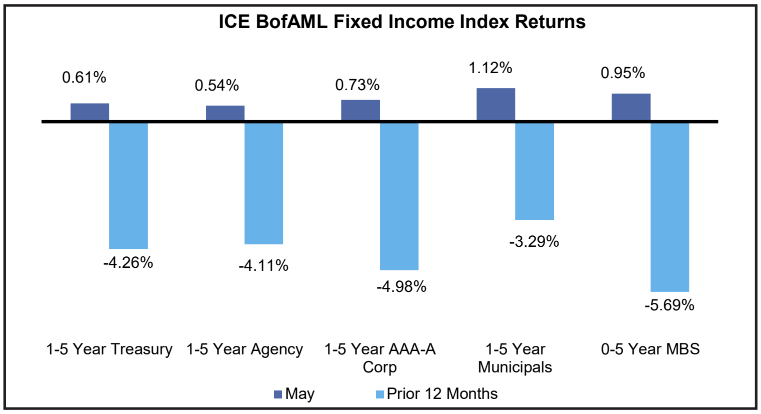
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	1.06%	1.15%	1.91%	--
6-Month	1.57%	1.41%	2.03%	--
2-Year	2.56%	2.57%	2.87%	1.78%
5-Year	2.82%	2.96%	3.41%	2.13%
10-Year	2.85%	3.24%	3.87%	2.60%
30-Year	3.05%	3.70%	4.35%	3.16%

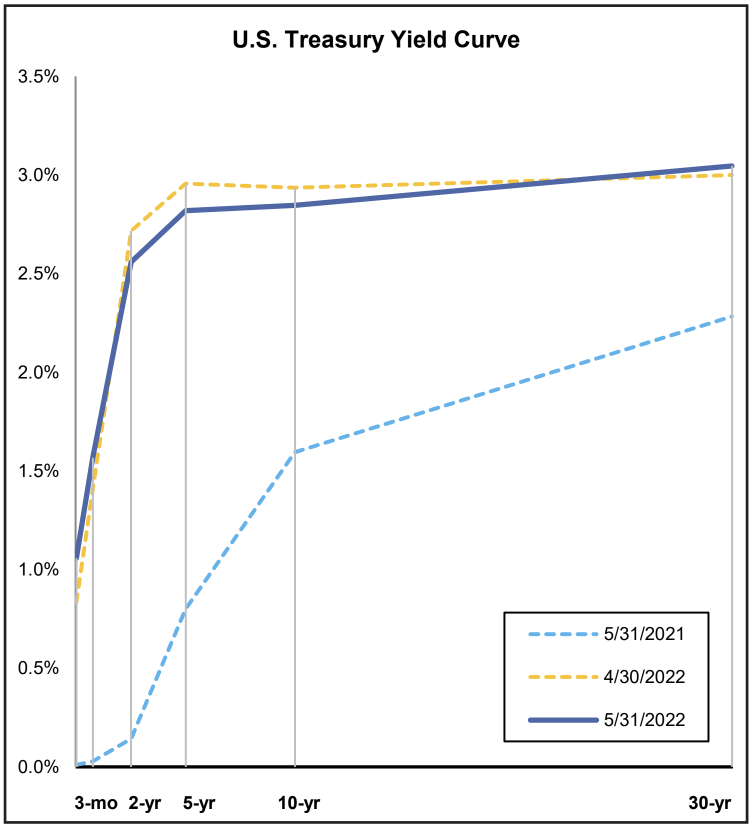
Spot Prices and Benchmark Rates

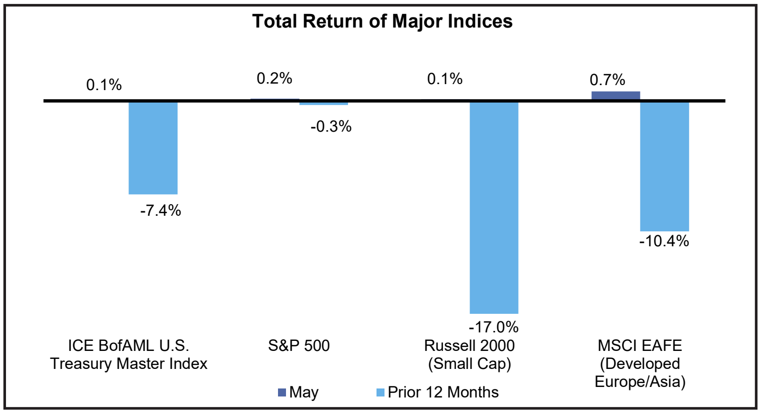
Index	May 31, 2021	Apr 30, 2022	May 31, 2022	Monthly Change
1-Month LIBOR	0.09%	0.80%	1.12%	0.32%
3-Month LIBOR	0.13%	1.33%	1.61%	0.28%
Effective Fed Funds Rate	0.05%	0.33%	0.83%	0.50%
Fed Funds Target Rate	0.25%	0.50%	1.00%	0.50%
Gold ($/oz)	$1,903	$1,912	$1,843	-$69
Crude Oil ($/Barrel)	$66.32	$104.69	$114.67	$9.98
U.S. Dollars per Euro	$1.22	$1.05	$1.07	$0.02

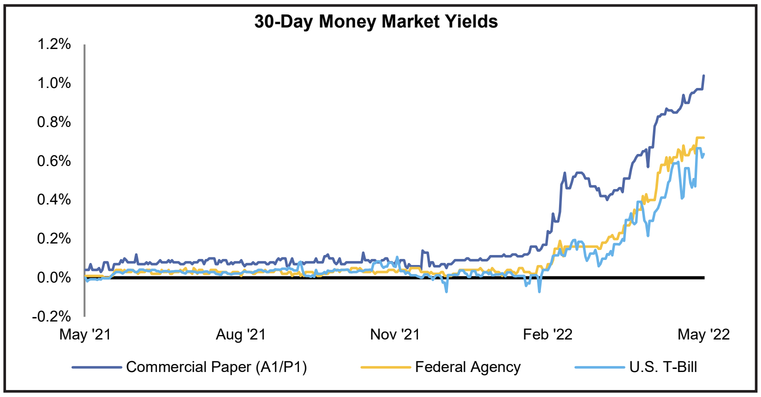
Key Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales Advance MoM	17-May	Apr	0.9%	1.0%
GDP Annualized QoQ	26-May	1Q S	-1.5%	-1.3%
PCE Core Deflator YoY	27-May	Apr	4.9%	4.9%
Consumer Confidence	31-May	May	106.4	103.6
ISM Manufacturing	1-Jun	May	56.1	54.5
Change in Non-Farm Payrolls	3-Jun	May	390k	318k
Unemployment Rate	3-Jun	May	3.6%	3.5%









Source: Bloomberg. Data as of May 31, 2022, unless otherwise noted.