Monthly Market Review

Fixed Income | May 2022

pfm asset management

"The Fed's highwire balancing act takes center stage."

Economic Highlights

► The war in Ukraine has lingered, creating a humanitarian crisis and causing inflationary pressures that could threaten the global economy. Fuel and food prices have increased rapidly, hitting the most vulnerable populations the hardest. In addition, new COVID-19 lockdowns in China contribute to persistent supply chain disruptions that continue to affect consumers and businesses.

► On May 4, the Federal Reserve (Fed) increased the fed funds rate by a half percent to a new target range of 0.75% to 1.00%. They also officially announced their plans to shrink the Fed's balance sheet from maturities and principal payments. Starting June 1, the runoff cap for Treasuries will initially be $30 billion per month, increasing to $60 billion after three months. The cap for agency mortgage-backed securities (MBS) will start at $17.5 billion per month and then increase to $35 billion after three months. Future sales, especially of MBS, may be necessary to achieve the Fed's reduction goals.

► The Consumer Price Index (CPI) rose by 8.3% year-over-year through April, just off March's 40-year high. Gasoline, food, shelter and transportation costs all contributed to the increase. Consequently, inflation remains the most pressing concern for consumers.

► Labor markets remained strong. Despite worker shortages, the U.S. economy added 428,000 jobs in April, bringing total job gains to nearly 2.1 million jobs so far in 2022. Although the labor force participation rate surprisingly weakened, the unemployment rate remained steady at a pandemic-low of 3.6% in April.

► Manufacturing activity slowed in April (although it remains expansionary) to the lowest level since September 2020 as growth in orders, production and employment all softened. Service sector activity also dipped in April.

Bond Markets

► Treasury yields continued to rise. The 2- and 10-year Treasury note yields finished at 2.72% and 2.94%, having jumped 38 and 60 basis points (bps) (0.38% and 0.60%), respectively, in the month. The continued rise came amid an increasingly hawkish tone from the Fed to pull forward rate hikes to combat persistent inflation.

► Higher yields again resulted in weak returns on bond indices. The ICE BofA 2-, 5-, and 10-year Treasury indices returned -0.56%, -2.08%, and -4.63%, respectively, for the month.

► Mortgage rates also shot up, reaching the highest level since August 2009 – 5.27% for a traditional 30-year fixed-rate mortgage. Higher borrowing costs have curtailed refinancing activity and are beginning to bite the housing market. Both new and existing home sales have fallen for two straight months, although home prices continued to increase.

Equity Markets

► Equity markets posted sharp declines in April amid tightening monetary policy, high inflation, and geopolitical uncertainty. The S&P 500 fell 8.7%, the Dow industrials declined nearly 5%, while the Nasdaq Composite retreated more than 13%, its worst month since October 2008. Global stocks also fell, with the ACWI ex-U.S. index falling 6.2%.

► As risk-off sentiment gripped global markets, the U.S. Dollar Index (DXY) jumped 4.8% in April, its largest monthly gain since January 2015.

PFMAM Strategy Recap

► The Fed is expected to continue tightening monetary policy, with rate increases of 50 bps now expected for the June, July and possibly September meetings. Although much of the expected increases are already captured in the term structure of today's yield curve, we plan to continue to maintain a modestly defensive duration bias relative to benchmarks. We will likely hold that position until we see signs of stabilization in both interest rates and the economic outlook.

► In Federal agency securities, new issuance is light and spreads are narrow. We continue to pare back holdings in favor of more attractive opportunities in other sectors.

► Investment-grade (IG) corporate spreads have widened since the beginning of the quarter and neared mid-March wides. Wider spreads are somewhat inconsistent with our view that a recession is unlikely this year, but we respect the growing level of uncertainty and weakening market liquidity. We plan to continue to consider new issues, as concessions have also widened recently, but have turned more neutral on the sector.

► Asset-backed security (ABS) spreads remain wide from a historical context, but the differential over high-quality corporates has decreased. Current valuations are attractive, but like corporates, spreads have been pressured wider. We are now neutral on the sector.

► We remain quite defensive in the MBS sector. We anticipate additional pain and underperformance in the sector over at least the near-term, and will likely maintain extreme selectivity for any new purchases.

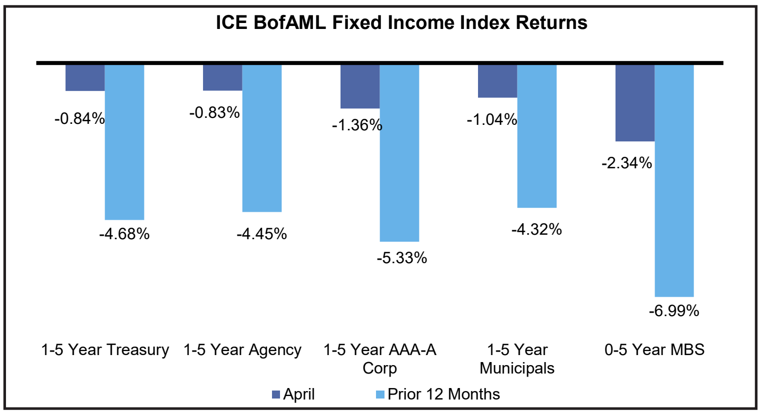
► In the money market sector, the yield curve is very steep from overnight to one year, and credit spreads are quite attractive. Investors in commercial paper and bank CDs are now well compensated compared to the near-zero rates throughout all of 2021.

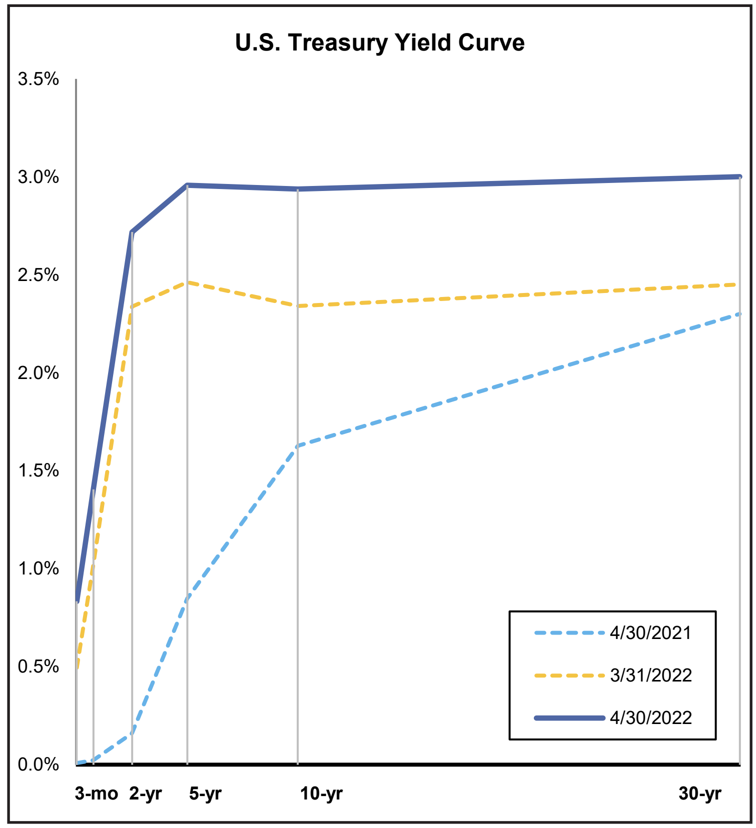
U.S. Treasury Yields				
Duration	**Apr 30, 2021**	**Mar 31, 2022**	**Apr 30, 2022**	**Monthly Change**
3-Month	0.01%	0.50%	0.83%	0.33%
6-Month	0.02%	1.02%	1.41%	0.39%
2-Year	0.16%	2.34%	2.72%	0.38%
5-Year	0.85%	2.46%	2.96%	0.50%
10-Year	1.63%	2.34%	2.94%	0.60%
30-Year	2.30%	2.45%	3.00%	0.55%

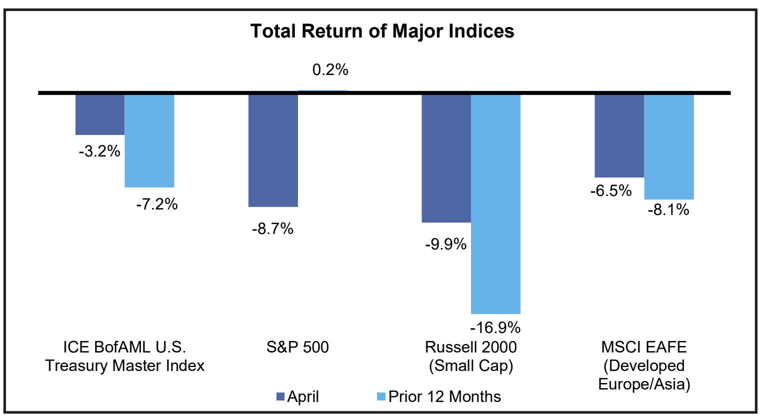
Yields by Sector and Maturity				
Maturity	**U.S. Treasury**	**Federal Agency**	**Corporates-A Industrials**	**AAA Municipals**
3-Month	0.83%	0.91%	2.06%	--
6-Month	1.41%	1.37%	2.17%	--
2-Year	2.72%	2.78%	3.01%	2.01%
5-Year	2.96%	3.03%	3.56%	2.36%
10-Year	2.94%	3.25%	3.97%	2.83%
30-Year	3.00%	3.72%	4.36%	3.41%

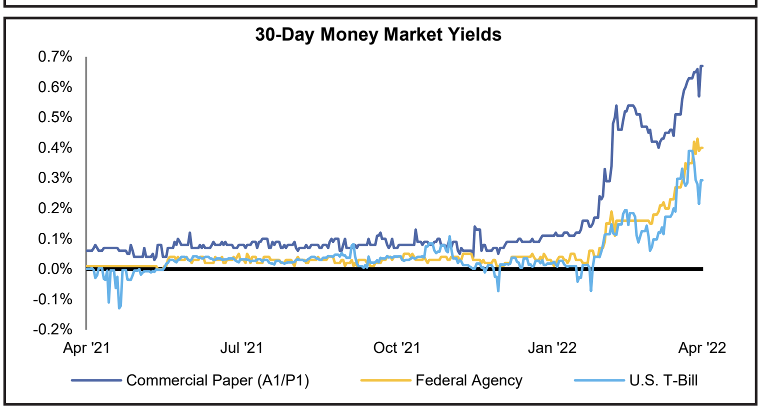
Spot Prices and Benchmark Rates				
Index	**Apr 30, 2021**	**Mar 31, 2022**	**Apr 30, 2022**	**Monthly Change**
1-Month LIBOR	0.11%	0.45%	0.80%	0.35%
3-Month LIBOR	0.18%	0.96%	1.33%	0.37%
Effective Fed Funds Rate	0.05%	0.33%	0.33%	0.00%
Fed Funds Target Rate	0.25%	0.50%	0.50%	0.00%
Gold ($/oz)	$1,768	$1,949	$1,912	-$38
Crude Oil ($/Barrel)	$63.58	$100.28	$104.69	$4.41
U.S. Dollars per Euro	$1.20	$1.11	$1.05	-$0.06

Key Economic Indicators				
Indicator	**Release Date**	**Period**	**Actual**	**Survey (Median)**
Retail Sales Advance MoM	14-Apr	Mar	0.5%	0.6%
Consumer Confidence	26-Apr	Apr	107.3	108.2
GDP Annualized QoQ	28-Apr	1Q A	-1.4%	1.0%
PCE Core Deflator YoY	29-Apr	Mar	5.2%	5.3%
ISM Manufacturing	2-May	Apr	55.4	57.6
Change in Non-Farm Payrolls	6-May	Apr	428k	380k
Unemployment Rate	6-May	Apr	3.6%	3.5%









Source: Bloomberg. Data as of April 30, 2022, unless otherwise noted.

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