# Monthly Market Review

**Fixed Income | August 2022**

**Information provided by Texas Range's Investment Advisor PFM Asset Management LLC**

TEXAS RANGE

**"All's well that ends well?"**

## Economic Highlights

► Jobs remain aplenty, inflation is set to improve, credit spreads narrowed and stocks posted an impressive rebound as the Federal Reserve (Fed) continues to align policy for a soft landing.

► The U.S. added 528,000 new jobs in July, more than double the expectations, while the unemployment rate improved to a 50-year low of 3.5% (the same rate during Woodstock in 1969!). Job growth was widespread, led by gains in leisure and hospitality, professional services and healthcare. Total non-farm employment has now finally returned to pre-pandemic levels.

► The Consumer Price Index (CPI) declined from a cycle high of 9.1% to a better-than-expected 8.5% year-over-year through July. Gasoline prices, used car prices and transportation services prices all declined in July. Gasoline prices, perhaps the most visible indicator of inflation, have fallen for 60 straight days since mid-June, going from a national average of $5.02 to $3.98 by mid-August. Despite the favorable headlines, food, shelter and medical care prices continued to rise.

► As expected, the Fed boosted the overnight federal funds rate by 75 basis points (bps) for the second straight time at its July 27 meeting, bringing short-term rates to a new target range of 2.25% to 2.50%. After holding rates near zero for two years, the Fed is now raising rates and tightening monetary policy to slow demand and, hopefully, moderate inflation pressures. Market expectations are for short-term rates to end the year around 3.5%, so more hikes are expected.

► U.S. gross domestic product (GDP) declined at an annual real rate of -0.9% in the second quarter, marking the second consecutive quarter of contraction. This reflected decreases in private inventories, residential housing, government spending, and business investment, partly offset by growth in consumer spending and exports. Although two quarters of negative growth meets one technical sign of recession, the official definition according to the National Bureau of Economic Research is "a significant decline in economic activity that is spread across the economy and that lasts more than a few months." Economists do not believe the U.S. is currently in a recession with a 3.5% unemployment rate.

► The housing market continued to cool, with new and existing home sales, building permits, housing starts, pending sales and mortgage applications all declining.

## Bond Markets

► The U.S. Treasury yield curve flattened in July as short-end yields increased on the Fed rate hike while yields on maturities greater than two years declined on expectations the Fed could pause in 2023. That view may be too optimistic, as several Fed governors have expressed the need to continue tightening.

► 6-month, 2-year, and 10-year Treasury yields finished the month at 2.84% (up 38 bps), 2.88% (down seven bps), and 2.65% (down 36 bps), respectively. By month-end, the inversion between 2- and 10-year Treasury yields reached the most since 2000.

► U.S. Treasury index returns were positive in July. The ICE BofA 6-month, 2-year, and 10-year Treasury indices returned 0.09%, 0.25%, and 3.07%, respectively. For longer indices, it was only the second positive month of the year.

## Equity Markets

► Stocks surged in July, with the S&P 500 jumping 9.2% amid a reversal in negativity around the impact of higher rates and concern about future earnings. At its worst in the current downturn, the S&P was down 22.5% but ended July down only 12.6% on the year. The Nasdaq had an even better month, up 12.4%, while international equities, as measured by the MSCI ACWI ex-U.S. Index, rose only 3.5%.

► The U.S. dollar index (DXY) reached a 20-year high before beginning a pullback mid-month. The dollar is up a remarkable 14.9% over the past year.

## PFMAM Strategy Recap

► With expectations for more Fed rate hikes, we maintained a slightly defensive duration bias relative to benchmarks. However, with the end perhaps in sight by early 2023, we plan to use any significant backup in yields to reduce that duration underweight and move closer to benchmarks.

► Federal agency "bullet" maturities continue to offer little value, but the recent spike in volatility has made callable agency spreads much wider and more interesting.

► Investment-grade (IG) corporate spreads narrowed throughout July as risk aversion moderated. Lower quality and longer duration bonds benefitted most from that spread compression. Up to this point, new issues have presented good buying opportunities, but with narrowing spreads, we intend to be more selective.

► Asset-backed security (ABS) spreads remained wide on a historical basis and appear quite attractive, offering both incremental yield and high-quality return prospects.

► Mortgage-backed securities (MBS) remain at risk from slowing prepayments, duration extensions and potential Fed selling pressure.

► Short-term commercial paper and bank CDs continue to offer excellent yield and spread opportunities, with 12-month maturities now approaching a 4% yield.

## U.S. Treasury Yields

| Duration | Jul 31, 2021 | Jun 30, 2022 | Jul 31, 2022 | Monthly Change |
|---|---|---|---|---|
| 3-Month | 0.04% | 1.67% | 2.36% | 0.69% |
| 6-Month | 0.05% | 2.49% | 2.86% | 0.37% |
| 2-Year | 0.19% | 2.96% | 2.89% | -0.07% |
| 5-Year | 0.69% | 3.04% | 2.68% | -0.36% |
| 10-Year | 1.22% | 3.02% | 2.65% | -0.37% |
| 30-Year | 1.89% | 3.19% | 3.01% | -0.18% |

## Yields by Sector and Maturity

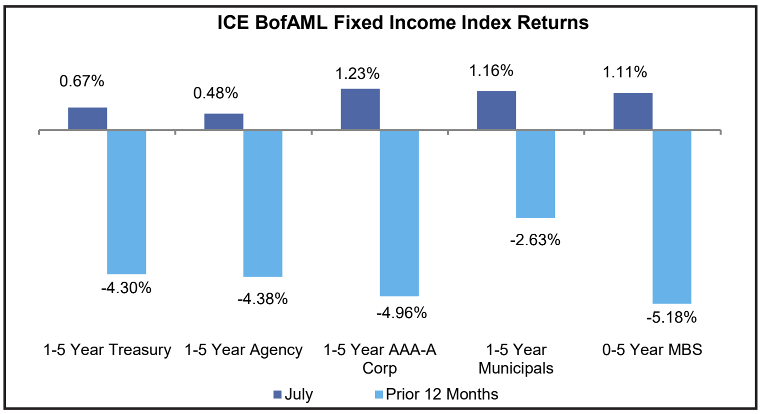
| Maturity | U.S. Treasury | Federal Agency | Corporates-A Industrials | AAA Municipals |
|---|---|---|---|---|
| 3-Month | 2.36% | 2.54% | 2.66% | -- |
| 6-Month | 2.86% | 2.93% | 2.74% | -- |
| 2-Year | 2.89% | 2.95% | 3.16% | 1.62% |
| 5-Year | 2.68% | 2.86% | 3.36% | 1.97% |
| 10-Year | 2.65% | 3.01% | 3.73% | 2.48% |
| 30-Year | 3.01% | 3.34% | 4.32% | 3.06% |

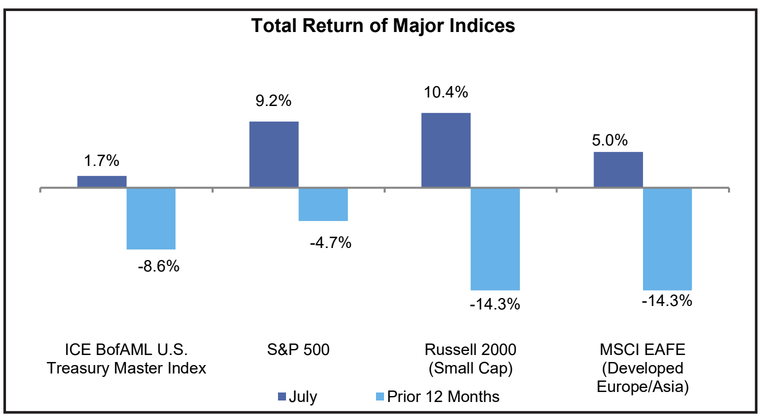
## Spot Prices and Benchmark Rates

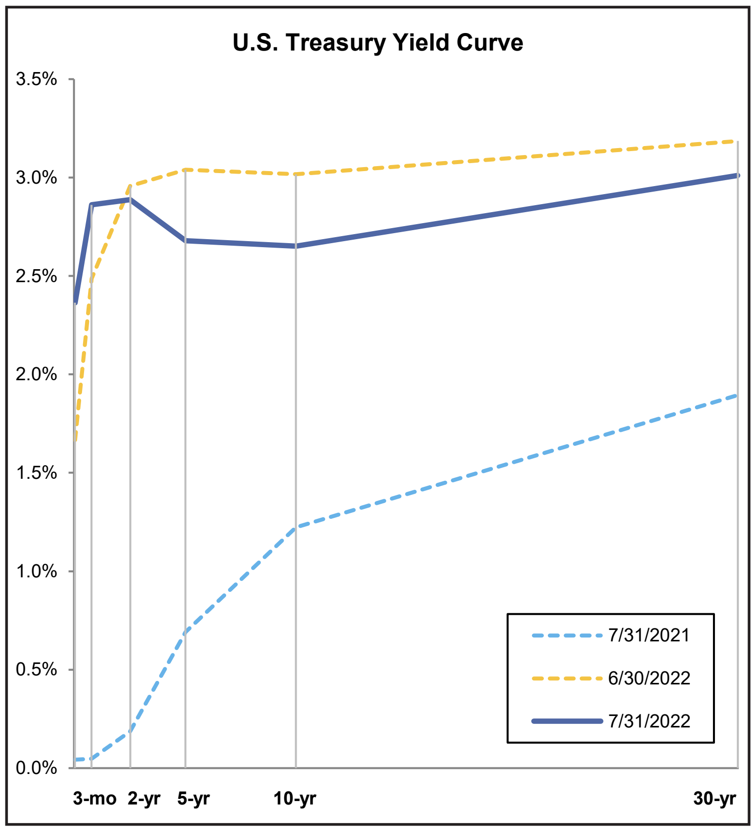
| Index | Jul 31, 2021 | Jun 30, 2022 | Jul 31, 2022 | Monthly Change |
|---|---|---|---|---|
| 1-Month LIBOR | 0.09% | 1.79% | 2.36% | 0.57% |
| 3-Month LIBOR | 0.12% | 2.29% | 2.79% | 0.50% |
| Effective Fed Funds Rate | 0.07% | 1.58% | 2.32% | 0.74% |
| Fed Funds Target Rate | 0.25% | 1.75% | 2.50% | 0.75% |
| Gold ($/oz) | $1,813 | $1,807 | $1,763 | -$44 |
| Crude Oil ($/Barrel) | $73.95 | $105.76 | $98.62 | -$7.14 |
| U.S. Dollars per Euro | $1.19 | $1.05 | $1.02 | -$0.03 |

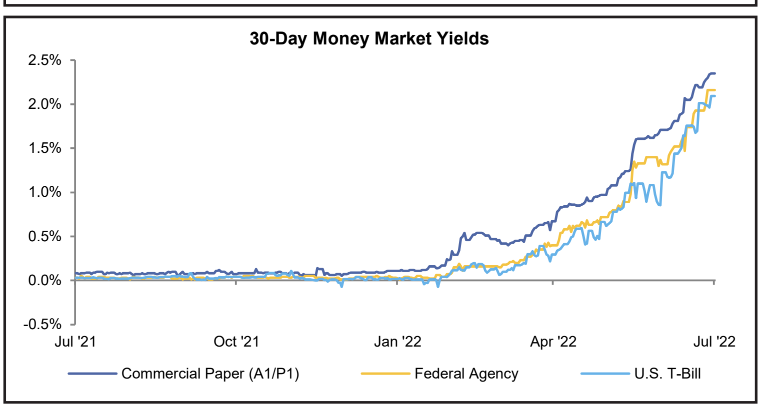
## Key Economic Indicators

| Indicator | Release Date | Period | Actual | Survey (Median) |
|---|---|---|---|---|
| Retail Sales Advance MoM | 15-Jul | Jun | 1.0% | 0.9% |
| GDP Annualized QoQ | 28-Jul | 2Q A | -0.9% | 0.4% |
| PCE Core Deflator YoY | 29-Jul | Jun | 4.8% | 4.7% |
| Consumer Confidence | 29-Jul | Jul | 51.5 | 51.1 |
| ISM Manufacturing | 1-Aug | Jul | 52.8 | 52.0 |
| Change in Non-Farm Payrolls | 5-Aug | Jul | 528k | 250k |
| Unemployment Rate | 5-Aug | Jul | 3.5% | 3.6% |




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