Monthly Market Review

Fixed Income | November 2022

Information provided by MOSIP's Investment Advisor PFM Asset Management LLC

MOSIP

"Sign, Sign, Everywhere a Sign."

Economic Highlights

► As expected, the Federal Reserve (Fed) announced a fourth consecutive 0.75% increase in the federal funds rate at its early November meeting. This latest hike pushed the benchmark rate to a new target range of 3.75% to 4.00%, the highest level since 2008. Fed Chair Jerome Powell said that the Federal Open Market Committee (FOMC) continued to "anticipate that ongoing increases will be appropriate" and "incoming data since our last meeting suggest that the ultimate level of interest rates will be higher than previously expected." These comments pushed the expected terminal rate to well over 5%.

► Chair Powell also said that "reducing inflation is likely to require a sustained period of below-trend growth and some softening of labor market conditions," but those signs have yet to materialize. U.S. real gross domestic product (GDP) accelerated at 2.6% pace in the third quarter, the first expansion after two consecutive quarters of negative growth. The increase in GDP reflected increases in net exports, consumer spending, business equipment, and government spending, that were partly offset by decreases in residential investment and inventories.

► In the final glimpse at the state of the economy ahead of midterm elections, readings on the labor market remained robust in October. Although the unemployment rate rose to 3.7%, the economy added 261,000 jobs in October, exceeding economists' projections. However, Americans are still seeing outsized wage gains.

► The Consumer Price Index (CPI), a key inflation barometer, fell to a better-than-expected year-over-year (YoY) rate of 7.7% in October, down from 8.2% the prior month. Excluding food and energy, "core" CPI was also better than expected, falling from 6.6% to 6.3% YoY. Increases in prices for food, shelter, cars, transportation, and medical care remained excessively high, but the report was the first real sign of moderating inflation.

► New-home sales fell 10.9% in September, which marks the fourth time in 2022 that these sales have fallen by 10% or more from the prior month. Considering multi-decade high mortgage rates, mortgage applications to purchase homes also fell 42% over the year. The average rate on a 30-year fixed-rate mortgage passed 7% on November 4, the first time in more than 20 years.

Bond Markets

► Bond yields continued to rise in whipsaw fashion as market volatility remained near historic highs. The benchmark 6-month, 2-year, and 10-year Treasury yields finished the month at 4.54%, 4.49%, and 4.05%, up 61, 21, and 22 basis points (0.61%, 0.21%, and 0.22%) for October, respectively. The 2-year Treasury yield rose to 4.73% in early November before falling back to 4.33% after the October CPI report.

► Fixed income U.S. Treasury index total returns were mixed in October with only the shortest-duration indices posting positive absolute returns. The ICE BofA 6-month, 2-year, and 10-year Treasury indices returned 0.17%, -0.21%, and -1.88%, respectively, for the month.

► The U.S. Treasury yield curve has been inverted for some time with the yield on 10-year Treasuries less than the yield on 2-year Treasuries. In an even stronger indicator of a future recession, the 10-year Treasury fell below the the yield on 3-month Treasuries for the first time this cycle. Ultimately, this measures the aggressiveness of the Fed's short-term rate policy.

Equity Markets

► The S&P 500 bounced back 8.1% in October, marking the second best monthly performance of 2022, as earnings came in better than expected. The Dow finished October up 14.1%, while the NASDAQ posted monthly gains of only 3.9%, a continuing theme as technology trailed in the current increasing-rate cycle.

► The U.S. dollar rally slowed in October, as the U.S. dollar Index (DXY) inched lower October. The index however remains near a 20+ year high.

PFMAM Strategy Recap

► Amid economic growth uncertainty, historically elevated bond volatility, and the expectation for the Fed to continue on the path of monetary policy tightening over at least the near term, we will likely maintain our modest defensive duration bias relative to benchmarks. However, given the strong income potential offered by today's yields, we may look to utilize bouts of market weakness to extend durations closer to benchmarks.

► While federal agency non-callable securities continue to offer limited relative value to U.S. Treasuries, some callable structures remain attractive from longer-term historical perspective. Liquidity continues to be a challenge in the agency sector as opportunistic sales have become impractical.

► Investment-grade (IG) corporate spreads widened in October, led initially by banks, and followed by many other sectors. With yield spreads reaching post-pandemic wides, the sector has become more attractive.

► Asset-backed security (ABS) spreads also widened in October in line with other spread sectors, although after lagging corporates for some time, the sector has not quite reached year-to-date wides from mid-May. Prime structures continue to offer sufficient credit enhancement relative to loss expectations, which is a plus for new issues.

► Mortgage-backed securities (MBS) remain under pressure and posted negative excess returns for the month as general housing market sentiment continues to sour. We remain defensive in the sector, however the shear magnitude of underperformance year-to-date has created opportunities to begin inching up allocations.

► Short-term credit (commercial paper and bank CDs) continue to offer excellent yield opportunities for short-term investors, with many yields well above longer-term Treasuries.

U.S. Treasury Yields

Duration	Oct 31, 2021	Sep 30, 2022	Oct 31, 2022	Monthly Change
3-Month	0.06%	3.27%	4.07%	0.80%
6-Month	0.06%	3.93%	4.54%	0.61%
2-Year	0.50%	4.28%	4.49%	0.21%
5-Year	1.19%	4.09%	4.23%	0.14%
10-Year	1.56%	3.83%	4.05%	0.22%
30-Year	1.93%	3.78%	4.17%	0.39%

Yields by Sector and Maturity

Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	4.07%	3.99%	4.60%	-
6-Month	4.54%	4.50%	4.66%	-
2-Year	4.49%	4.62%	4.93%	3.05%
5-Year	4.23%	4.43%	5.06%	3.16%
10-Year	4.05%	4.55%	5.28%	3.52%
30-Year	4.17%	4.84%	5.64%	4.09%

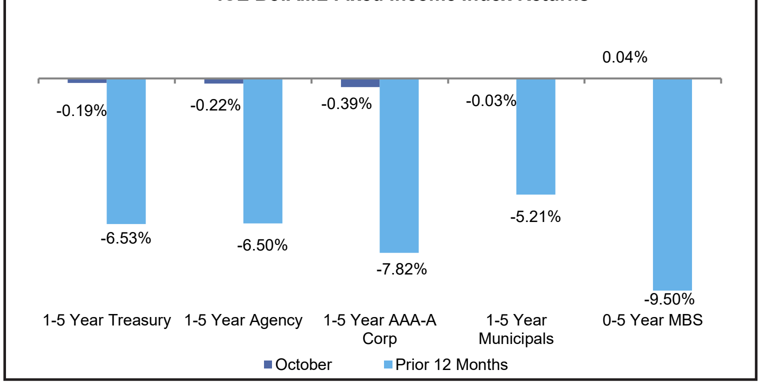
Spot Prices and Benchmark Rates

Index	Oct 31, 2021	Sep 30, 2022	Oct 31, 2022	Monthly Change
1-Month LIBOR	0.09%	3.14%	3.80%	0.66%
3-Month LIBOR	0.13%	3.75%	4.46%	0.71%
Effective Fed Funds Rate	0.07%	3.08%	3.08%	0.00%
Fed Funds Target Rate	0.25%	3.25%	3.25%	0.00%
Gold ($/oz)	$1,784	$1,662	$1,641	-$22
Crude Oil ($/Barrel)	$83.57	$79.49	$86.53	$7.04
U.S. Dollars per Euro	$1.16	$0.98	$0.99	$0.01

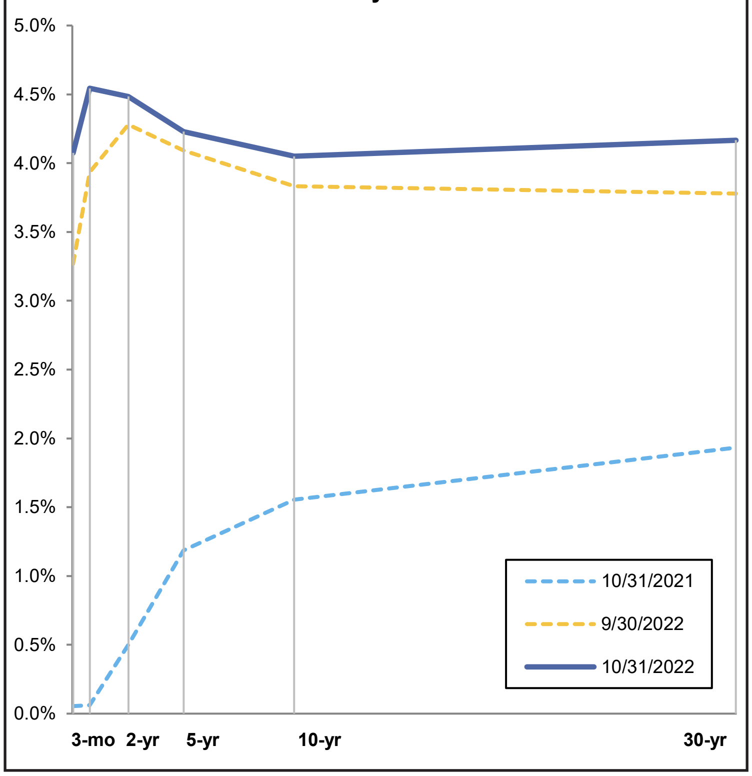
Key Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
GDP Annualized QoQ	27-Oct	3Q A	2.6%	2.4%
PCE Core Deflator YoY	28-Oct	Sep	5.1%	5.2%
U. of Mich. Consumer Sentiment	28-Oct	Oct	59.9	59.6
ISM Manufacturing	1-Nov	Oct	50.2	50.0
FOMC Rate Decision (Lower)	2-Nov	Nov 2	3.75%	3.75%
Change in Nonfarm Payrolls	4-Nov	Oct	261k	193k
Unemployment Rate	4-Nov	Oct	3.7%	3.6%

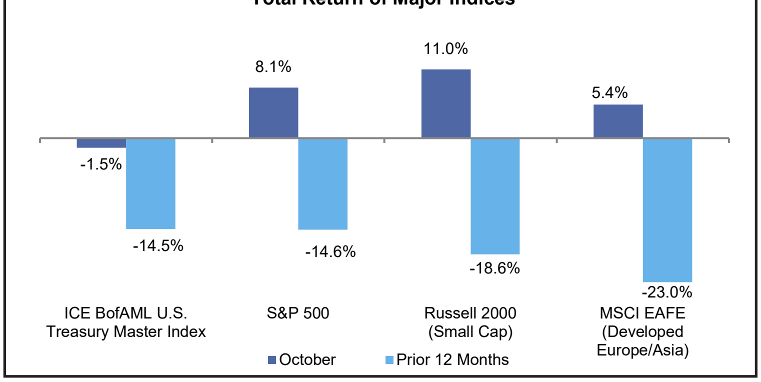
ICE BofAML Fixed Income Index Returns



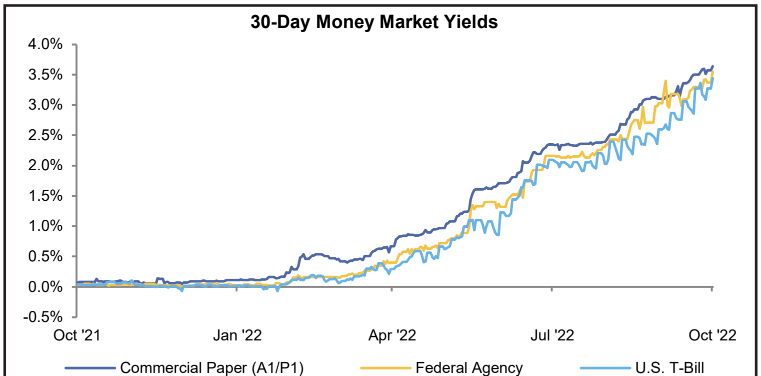
U.S. Treasury Yield Curve



Total Return of Major Indices



30-Day Money Market Yields



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

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