Monthly Market Review

Fixed Income | February 2023

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

MOSIP MISSOURI SECURITIES INVESTMENT PROGRAM

"Breaker, breaker; are we clear for a soft landing?"

Economic Highlights

► Recession worries persist, but readings of consumer spending and business investment are still showing growth. Strong labor market conditions and slowly but surely moderating inflation have kept the door open for a soft landing.

► On February 1, the Federal Reserve (Fed) voted to raise the federal funds overnight target rate by 25 basis points (bps) to a new range of 4.50% to 4.75%. This marks a modest downshift following the 50 bp hike in December and the preceding four consecutive 75 bp hikes. Comments from Fed Chair Jerome Powell emphasized that the Fed anticipates "ongoing increases" may be needed to tame inflation. The Committee meets next on March 22, 2023.

► The Consumer Price Index (CPI) rose 6.5% year-over-year in December, down from 7.1% in November. Headline CPI has now moderated for six consecutive months following the June peak of 9.1%.

► The labor market remains strong as the economy added 517,000 jobs in January, significantly outpacing expectations of 189,000 and the prior release of 260,000. The unemployment rate fell to 3.4%. The Fed has reiterated that the current tightening cycle is likely to result in softening in the labor market, although these figures have yet to materialize that notion. As a result of the blockbuster January jobs report, market sentiment adjusted around expectations for a slightly higher terminal rate and reduced potential for rate cuts in 2023.

► Real gross domestic product (GDP) rose 2.9% in the fourth quarter of 2022, after growth of 3.2% in the third quarter and two consecutive prior negative releases. This puts the first estimate of overall U.S. economic growth for the calendar year 2022 at 2.1%. While the 2022 estimate is more in line with pre-pandemic growth rates in the 1.7% to 2.9% range, estimates for 2023 and 2024 tell a different story, with economists' median results showing 0.5% and 1.2%, respectively.

► On the housing front, total existing-home sales dropped 1.5% from November to December, marking the eleventh consecutive month of declining sales.

► Economic activity in the U.S. manufacturing sector remained in contractionary territory in January for the third consecutive month. The measure dipped further to 47.4 from 48.4 in December. On the flip side, activity in the services sector jumped in January to 55.2 after a brief contractionary dip of 49.2 in December.

Bond Markets

► The U.S. Treasury yield curve remained near historically negative levels of inversion, as yields on maturities greater than six months declined through January.

► The benchmark 3-month, 2- and 10-year U.S. Treasury yields finished the month at 4.67%, 4.20%, and 3.51%, up 30 bps, down 23 bps, and down 37 basis points for the month, respectively.

► Fixed income U.S. Treasury index total returns broadly advanced in January across all tenors. The ICE BofA 6-month and 2-year indices generated positive returns of 0.34% and 0.64%, respectively. The longer 5- and 10-year Treasury indices returned 1.85% and 3.04%, respectively.

Equity Markets

► On the heels of a painful 2022, equity markets surged through January on broad risk-on-market sentiment to start the year, with all three of the major domestic averages pushing higher. The Dow Jones Industrial Average rose 2.9% in January, while the S&P 500 Index increased 6.3% and the Nasdaq was up 10.7%.

► The U.S. dollar extended losses in January from its September peak (multi-decade high), as the U.S. dollar Index (DXY) drove 1.4% lower for the month.

PFMAM Strategy Recap

► Amid economic growth and a steadfast Fed, we will likely maintain our modest defensive duration bias relative to benchmarks for now. We will continue to utilize bouts of oversold market weakness to extend durations closer to benchmarks.

► Investment-grade (IG) corporate spreads ground markedly tighter in January, breaking through recent lows set in August 2022 and are now below their 12-month average. After multiple months of a constructive view on elevated IG spreads, we now generally view the sector as less attractive, with most industries outside of financials and banks offering significantly reduced value. Patience and selectivity will be critical over the near term as markets weigh firm corporate fundamentals with varying outlooks for the severity of a potential recession over coming quarters.

► Government alternatives remain unattractive as the trend in weaker liquidity (bid/ask spreads) has not changed materially over recent months. Nevertheless, supranationals, municipals and federal agencies all benefited from risk-on sentiment and generated modestly positive excess returns relative to U.S. Treasuries.

► Asset-backed security (ABS) spreads also narrowed, although not to the extent of IG corporates, and remain above 12-month averages. We expect spread volatility to remain as markets focus on inflation data, Fed policy and most notably the health of the consumer in 2023.

► The mortgage-backed securities (MBS) sector maintained momentum from the fourth quarter and was a top-of-class performer to kickstart the year. After outperforming by 106 bps during the fourth quarter, the MBS sector continued its positive path, generating a 93 bp excess return for January.

U.S. Treasury Yields

Duration	Jan 31, 2022	Dec 31, 2022	Jan 31, 2023	Monthly Change
3-Month	0.19%	4.37%	4.67%	0.30%
6-Month	0.46%	4.76%	4.83%	0.07%
2-Year	1.18%	4.43%	4.20%	-0.23%
5-Year	1.61%	4.01%	3.62%	-0.39%
10-Year	1.78%	3.88%	3.51%	-0.37%
30-Year	2.11%	3.97%	3.63%	-0.34%

Yields by Sector and Maturity

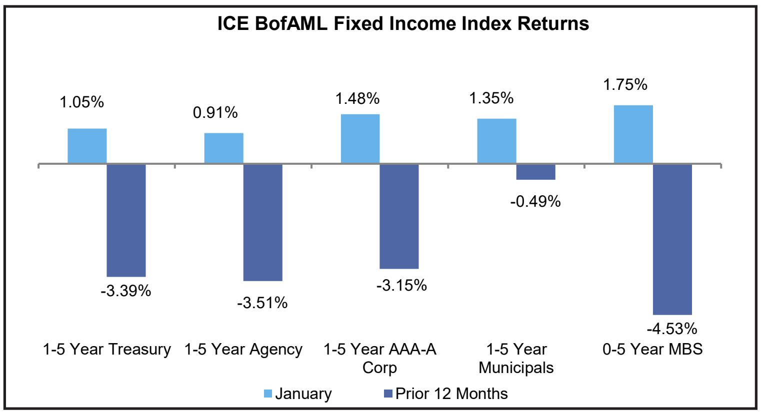
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	4.67%	4.66%	4.58%	-
6-Month	4.83%	4.80%	4.58%	-
2-Year	4.20%	4.34%	4.48%	2.20%
5-Year	3.62%	3.81%	4.32%	2.20%
10-Year	3.51%	3.65%	4.43%	2.64%
30-Year	3.63%	3.50%	4.77%	3.22%

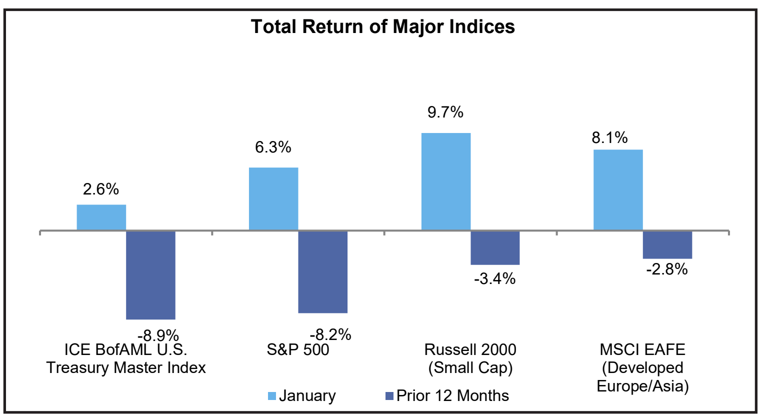
Spot Prices and Benchmark Rates

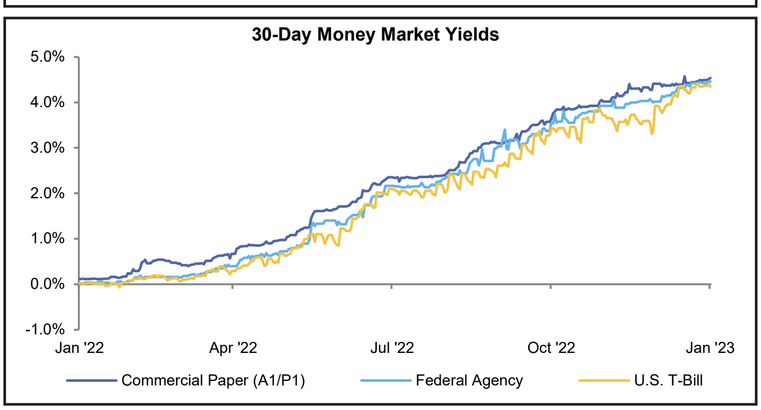
Index	Jan 31, 2022	Dec 31, 2022	Jan 31, 2023	Monthly Change
1-Month LIBOR	0.11%	4.39%	4.57%	0.18%
3-Month LIBOR	0.31%	4.77%	4.81%	0.04%
Effective Fed Funds Rate	0.08%	4.33%	4.33%	0.00%
Fed Funds Target Rate	0.25%	4.50%	4.50%	0.00%
Gold ($/oz)	$1,795	$1,826	$1,930	$103
Crude Oil ($/Barrel)	$88.15	$80.26	$78.87	-$1.39
U.S. Dollars per Euro	$1.12	$1.07	$1.09	$0.02

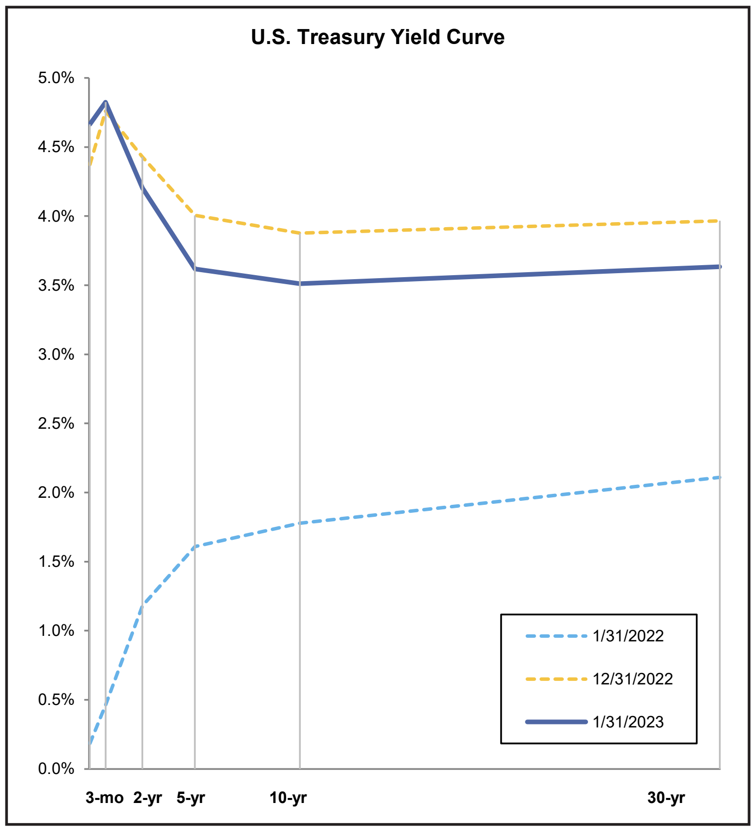
Key Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
ISM Manufacturing	4-Jan	Dec	48.4	48.5
CPI YoY	12-Jan	Dec	6.50%	6.50%
Retail Sales Advance MoM	18-Jan	Dec	-1.10%	-0.90%
GDP Annualized QoQ	25-Jan	4Q A	2.90%	2.60%
FOMC Rate Decision	1-Feb	Feb	4.50%	4.50%
Change in Nonfarm Payrolls	3-Feb	Jan	517K	189K
Unemployment Rate	3-Feb	Jan	3.40%	3.60%









Source: Bloomberg. Data as of January 31, 2023, unless otherwise noted.

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