Monthly Market Review

Fixed Income | March 2022

pfm asset management

"Back to the Future: 80s Inflation and Cold War Redux."

Economic Highlights

► Russia invaded Ukraine after months of military mobilization. Amid the tragic loss of life, war implications further disrupted supply chains, led to a surge in commodity prices, and triggered a sell-off in equity markets. In response, the United States and its Allies imposed sanctions on Russia, which included: 1) restrictions on Russian banks, 2) asset freezes and travel bans, 3) exclusion from the Swift payment system, and 4) blocking access to certain high-tech products. The crisis is also forcing a reassessment of European integration, security, and energy policy and dependencies.

► Consumer inflation climbed to its fastest annual rate since 1982 amid rising energy prices, strong consumer demand and ongoing supply constraints. Price increases were broad-based in the February report with outsized increases in gasoline, food, transportation, clothing and shelter costs. The rising cost of living continues to erode spending power, leading certain measures of consumer sentiment to fall to a new decade low.

► U.S. labor market continued to tighten, with the economy adding a better-than-expected 678,000 jobs in February and the jobless rate falling to 3.8%. The strong February jobs report, coupled with high producer and consumer price increases, adds further impetus for the Federal Reserve (Fed) to raise rates despite escalating geopolitical uncertainty.

► Manufacturing activity accelerated in February, while service sector activity expanded at a much slower pace. Survey commentary centered on strong demand amid logistics issues, while observations about labor shortages were less prominent than in prior reports.

► Fed Chair Jerome Powell testified before the House Financial Services and Senate Banking Committees. The Fed chair voiced his support for a rate hike at the upcoming March meeting but noted that officials could tighten at a faster clip if necessary to combat persistent inflation. Powell also acknowledged that geopolitical tensions have added uncertainty to the outlook, but have not shaken the Fed off its expected course.

Bond Markets

► U.S. Treasury yields continued their ascent higher across, with maturities between one and three years leading the charge, up 0.20% to 0.25%. The yield on the benchmark 2-year Treasury note rose from 1.18% to 1.43%, with momentum to rise further as the Fed nears liftoff.

► Treasury returns remained challenged in February as yields continued to reprice higher. The ICE BofA 1-, 5-, and 10-year constant maturity Treasury indices returned -0.16%, -0.43%, and -0.36%, respectively.

Equity Markets

► Equity markets remained risk-off in February as the Russia and Ukraine conflict intensified. The S&P 500 declined 3.0%, while the Dow Jones Industrial Average and the tech-heavy Nasdaq both fell 3.3%. European stocks were down a bit more, as the Euro Stoxx 50 index fell 6%.

► Commodity prices surged notably over the first week of March, especially those impacted by the Russian invasion of Ukraine. Crude oil prices briefly exceeded $120 per barrel, the highest level since 2008. In addition, key commodities like corn, wheat, aluminum and iron ore were all up more than 20% YTD.

PFMAM Strategy Recap

► The Russian invasion of Ukraine has created significant geopolitical uncertainty. PFMAM will continue to carefully monitor developments in Ukraine for implications for the global economy, on companies with sales or operations in Russia or Ukraine, and on banks with loan exposure to the region.

► Given the expectation for the Fed to stay the course on the monetary policy tightening plans, we still expect Treasury yields to continue to move higher. As a result, we will maintain a modestly defensive duration bias relative to benchmarks.

► Investment-grade (IG) corporate spreads have widened meaningfully with much of the move attributed to the broad risk-off sentiment. Corporate valuations are now favorable, with increased carry and attractive credit roll-down. Although spreads are not expected to return to historic tightening, the sector could face additional pressure if the conflict between Russia and Ukraine worsens or if the domestic economy begins to slow. Stable corporate fundamentals and favorable financial conditions remain our baseline expectation for now, but inflation, labor shortages and supply chain issues headline important risks.

► Asset-backed securities (ABS) spreads have also widened notably and are now closer to historical averages. Spreads are still subject to general market volatility, but valuations have improved. Cumulative net losses and delinquencies are beginning to tick up, but remain comfortably within expected ranges.

► The mortgage-backed securities (MBS) sector remains under pressure as the impact of Fed balance sheet run-off and taper have largely been the culprit leading to poor performance from the sector. We continue to remain defensive and especially selective.

► In the money market space, short-term rates have moved materially higher, pricing the expected series of rate hikes. Sort-term credit spreads also widened, as investors accumulated cash ahead of the March Fed meeting creating some supply/demand imbalances.

U.S. Treasury Yields

Duration	Feb 28, 2021	Jan 31, 2022	Feb 28, 2022	Monthly Change
3-Month	0.04%	0.19%	0.31%	0.12%
6-Month	0.05%	0.46%	0.64%	0.18%
2-Year	0.13%	1.18%	1.43%	0.25%
5-Year	0.73%	1.61%	1.72%	0.11%
10-Year	1.41%	1.78%	1.83%	0.05%
30-Year	2.15%	2.11%	2.16%	0.05%

Yields by Sector and Maturity

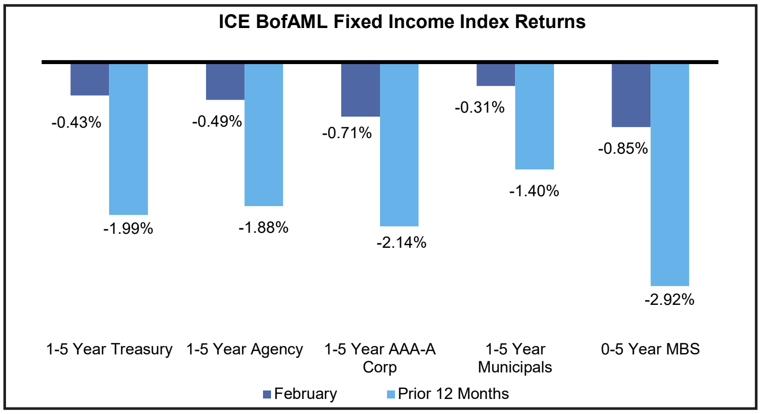
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	0.31%	0.34%	1.06%	--
6-Month	0.64%	0.42%	1.13%	--
2-Year	1.43%	1.55%	1.72%	0.97%
5-Year	1.72%	1.84%	2.33%	1.30%
10-Year	1.83%	2.13%	2.85%	1.87%
30-Year	2.16%	2.60%	3.46%	2.40%

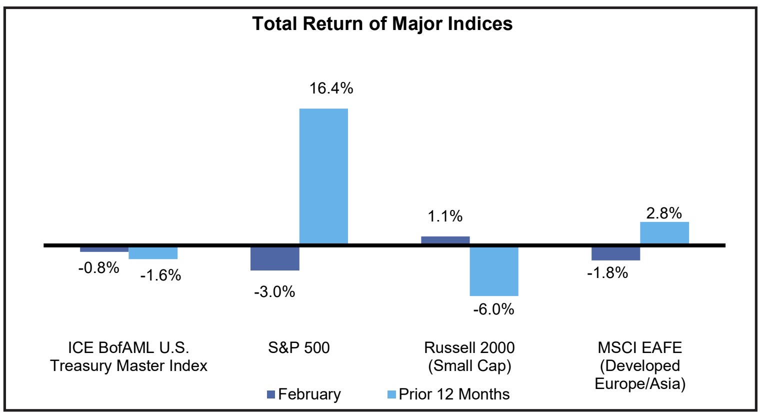
Spot Prices and Benchmark Rates

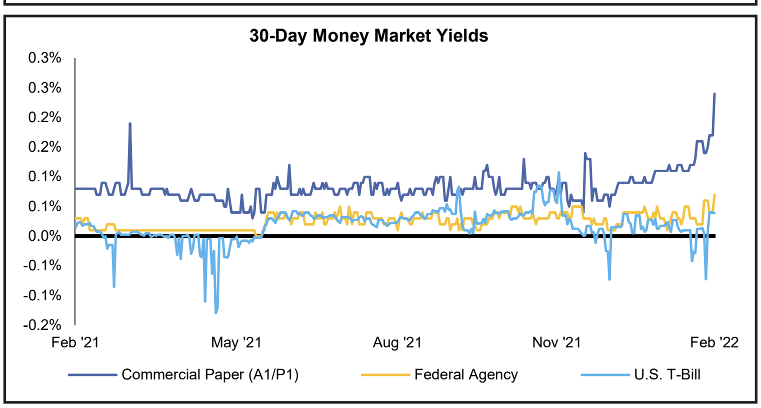
Index	Feb 28, 2021	Jan 31, 2022	Feb 28, 2022	Monthly Change
1-Month LIBOR	0.12%	0.11%	0.24%	0.13%
3-Month LIBOR	0.19%	0.31%	0.50%	0.19%
Effective Fed Funds Rate	0.07%	0.08%	0.08%	0.00%
Fed Funds Target Rate	0.25%	0.25%	0.25%	0.00%
Gold ($/oz)	$1,729	$1,795	$1,901	$106
Crude Oil ($/Barrel)	$61.50	$88.15	$95.72	$7.57
U.S. Dollars per Euro	$1.21	$1.12	$1.12	$0.00

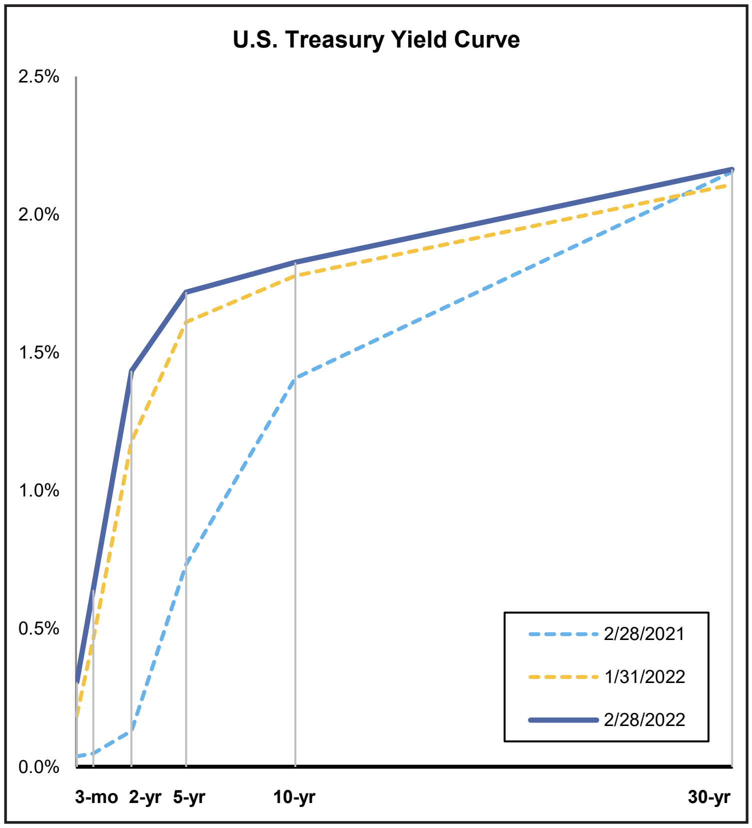
Key Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales Advance MoM	16-Feb	Jan	3.8%	2.0%
Consumer Confidence	22-Feb	Feb	110.5	110.0
GDP Annualized QoQ	24-Feb	4Q S	7.0%	7.0%
PCE Core Deflator YoY	25-Feb	Jan	5.2%	5.2%
ISM Manufacturing	1-Mar	Feb	58.6	58.0
Change in Non-Farm Payrolls	4-Mar	Feb	678k	423k
Unemployment Rate	4-Mar	Feb	3.8%	3.9%









Source: Bloomberg. Data as of February 28, 2022, unless otherwise noted.

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