Monthly Market Review

"Build Back Better" — Bullish for the economy, challenging for the bond market.

Economic Highlights

- January, true to the name's Latin roots, marked beginnings and transitions in the new year. A new administration began in Washington D.C., shattering racial and gender barriers across the new leadership team, portending major policy changes. At the same time, the COVID-19 pandemic continued to take its toll on health and wellbeing, while an early phase of the vaccination program held out hope for bringing the disease under control.
- Consumer and business confidence fell amid a strong resurgence of COVID-19 cases, an initially slow vaccine rollout and political unrest that culminated in the capitol siege on January 6.
- Joe Biden was sworn in as the 46th President of the United States and quickly signed a historic number of executive actions, reversing many of the former administration's policies. The immediate priorities were then focused on fighting the COVID-19 pandemic and enacting a $1.9 trillion economic relief package designed to support families, schools and businesses.
- As expected, the Federal Reserve (Fed) maintained near-zero short-term rates and reaffirmed its commitment to support employment and manage price stability. The Fed kept the large scale of its current asset purchase program of $120 billion in government bonds per month.
- The U.S. labor market faltered as the economy added only 49,000 jobs in January, following a revised-lower 227,000 job loss in December. Although the number of Americans filing for unemployment benefits fell, it has remained above 700,000 for 47 straight weeks. The unemployment rate fell to 6.3%, but the improvement has come mainly because people have left the workforce. Total non-farm employment is nearly 10 million lower than pre-pandemic levels.
- The housing market strength is seemingly immune to the ongoing pandemic. After a small November dip, both existing and new home sales rebounded in December, supported by record-low mortgage rates.

Bond Markets

- The U.S. Treasury yield curve steepened in January due to anticipated economic improvement later in the year and the potential for higher inflation. The yield on the benchmark 2-year note was relatively unchanged at 0.11%, while the yield on the 10-year note rose 15 basis points (bps) to 1.07%, pushing the 2-year to 10-year maturity yield spread to the highest level since 2017.
- Rising yields on longer-dated U.S. Treasuries produced negative returns for the month, while stable yields on short maturities generated marginally positive returns. The 3-month and 2-year Treasury indices returned 0.01% in January, while the 10-year index posted a loss of 1.62%.
- Financing conditions remain favorable, supporting somewhat higher monthly returns for investment-grade (IG) corporate bonds compared to matched maturity Treasuries. Corporate issuance was robust, an indication that companies are continuing to take advantage of the attractive borrowing environment.

Equity Markets

- After a strong 2020, equity markets waffled, ultimately posting mostly modest losses for January — the S&P 500 declined 1.0% and the Dow Jones Industrial Average fell 2.0%, while the Nasdaq rose 1.4%, supported by a solid earnings season.
- Global developed market equities, which trailed the U.S. last year, produced small positive returns in January. The U.S. Dollar Index (DXY) appreciated, rebounding from a two-and-a-half year low.

PFM Strategy Recap

- COVID-19 continues to dominate the economic outlook – essentially a battle between the surging virus and the vaccine rollout. While the virus seemed to be winning that battle in the fourth quarter, substantially increased vaccine distribution and waning of the holiday surge seems to have turned the corner – a strong positive for the economy.
- Business activity and payroll growth have moderated, but we are optimistic about further recovery prospects. Propelled by a drop in virus incidence and the likelihood of another sizeable fiscal relief package, GDP could expand strongly in the coming months. Concerns about inflation will be fed by pandemic-related dislocations and the wide U.S. budget deficit, but we believe the central bank's determination to address employment gaps and income inequality will dampen near-term rises in interest rates. Considering all of this, we recommend a modest shift in portfolio durations to be slightly defensive. The shift should be a bit greater in intermediate- and longer-term strategies due to the potential for further yield curve steepening.
- Ultra-low short-term rates and the prospect for an expanding economy have narrowed the income advantage of federal agency and IG corporate bonds to historically low levels. As a result, we may opportunistically sell existing holdings where near-zero yield spreads no longer offer any income or potential return benefit.
- In line with the theme of stretched valuations across the IG landscape, securitized products are also rich on a historical basis, including both AAA-rated asset-backed securities (ABS) and mortgage-backed securities (MBS). We plan to maintain core positions but exercise caution and selectivity for new purchases.
- The money markets remain awash in investable cash, pushing short-term rates and credit spreads even lower. Large pay-downs in Treasury bills will reduce the supply of short-term government debt as the Treasury seeks to reduce its cash balance and extend its issuance maturity in the coming months. Meanwhile, several trillion dollars of excess bank reserves will also pressure cash yields even closer to zero, perhaps forcing the Fed to intervene to avoid a fall into negative yield territory.

U.S. Treasury Yields

Duration	Jan 31, 2020	Dec 31, 2020	Jan 31, 2021	Monthly Change
3-Month	1.55%	0.07%	0.05%	-0.02%
6-Month	1.53%	0.09%	0.07%	-0.02%
2-Year	1.32%	0.12%	0.11%	-0.01%
5-Year	1.31%	0.36%	0.42%	0.06%
10-Year	1.51%	0.92%	1.07%	0.15%
30-Year	2.00%	1.65%	1.83%	0.18%

Yields by Sector and Maturity as of January 31, 2021

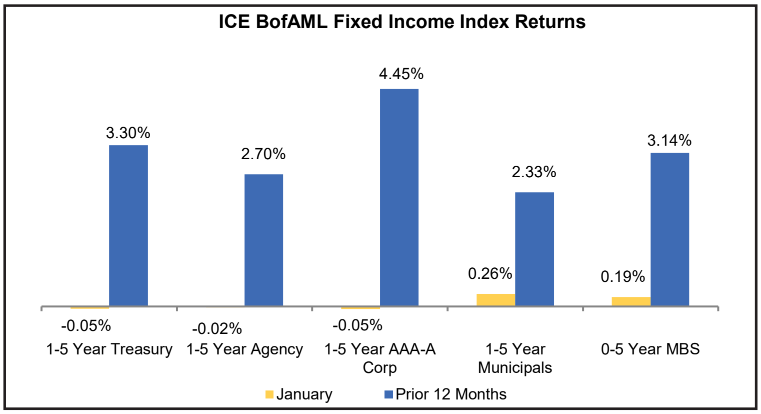
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	0.05%	0.04%	0.17%	--
6-Month	0.07%	0.04%	0.20%	--
2-Year	0.11%	0.13%	0.29%	0.26%
5-Year	0.42%	0.48%	0.78%	0.50%
10-Year	1.07%	1.23%	1.69%	1.06%
30-Year	1.83%	1.90%	2.77%	1.61%

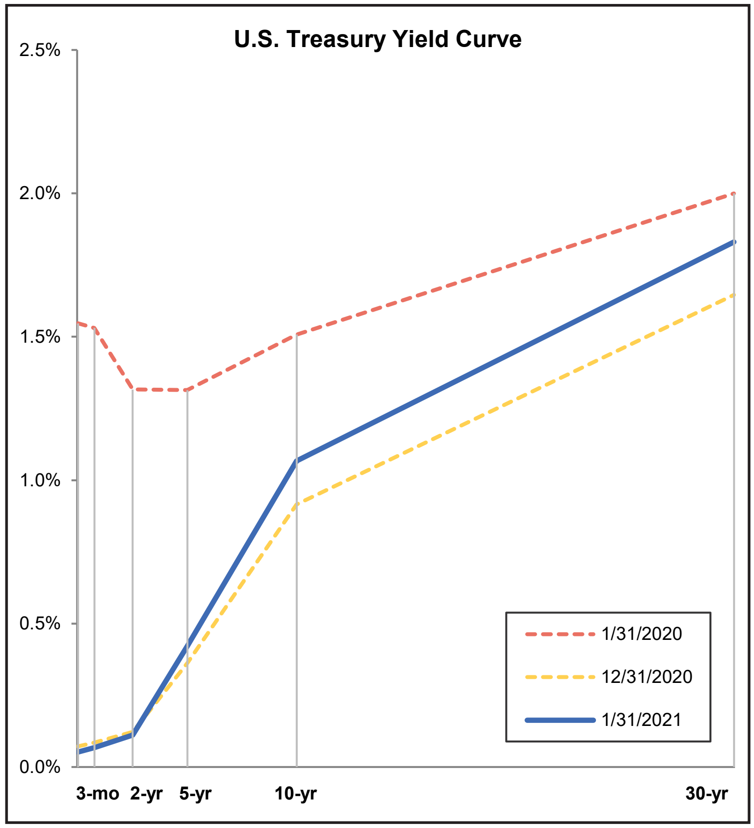
Spot Prices and Benchmark Rates

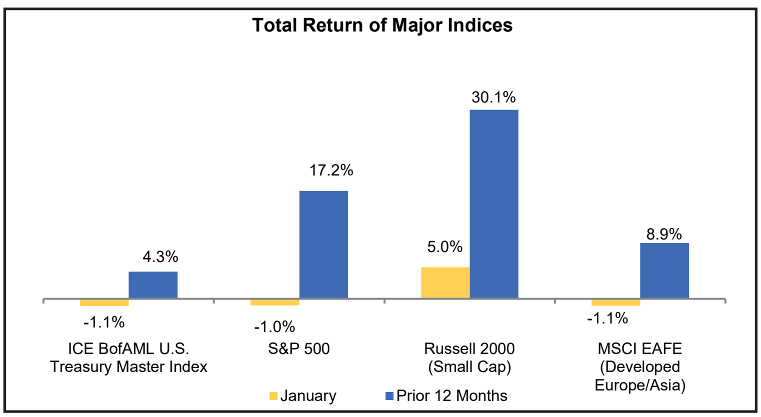
Index	Jan 31, 2020	Dec 31, 2020	Jan 31, 2021	Monthly Change
1-Month LIBOR	1.66%	0.14%	0.12%	-0.02%
3-Month LIBOR	1.75%	0.24%	0.20%	-0.04%
Effective Fed Funds Rate	1.59%	0.09%	0.07%	-0.02%
Fed Funds Target Rate	1.75%	0.25%	0.25%	0.00%
Gold ($/oz)	$1,583	$1,895	$1,847	-$48
Crude Oil ($/Barrel)	$51.56	$48.52	$52.20	$3.68
U.S. Dollars per Euro	$1.11	$1.22	$1.21	-$0.01

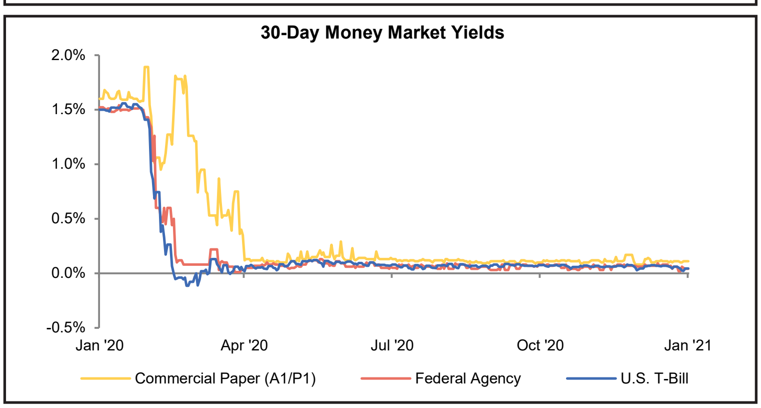
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales Advance MoM	15-Jan	Dec	-0.7%	0.0%
Consumer Confidence	26-Jan	Jan	89.3	89.0
GDP Annualized QoQ	28-Jan	4Q A	4.0%	4.2%
PCE Core Deflator YoY	29-Jan	Dec	1.5%	1.3%
ISM Manufacturing	1-Feb	Jan	58.7	60.0
Change in Nonfarm Payrolls	5-Feb	Jan	49k	105k
Unemployment Rate	5-Feb	Jan	6.3%	6.7%









Source: Bloomberg. Data as of January 31, 2021, unless otherwise noted.

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