Monthly Market Review

"Injustice anywhere is a threat to justice everywhere." — Martin Luther King, Jr.

Economic Highlights

- U.S. states and countries around the world sought to boost economic activity and a return to normalcy as many businesses were permitted to re-open under relaxed social distancing measures. Simultaneously, however, long-simmering racial tensions erupted into worldwide protests and the subject of police brutality took center stage after the death of Minneapolis resident, George Floyd. While the world attempts to look itself in the mirror, the uncertainty of the global health crisis remains.
- In an effort to ensure the smooth functioning of financial markets amid the coronavirus pandemic, the U.S. Federal Reserve (Fed) and central banks around the globe continued to ramp up a historic amount of monetary support. The Fed's balance sheet expanded from $4 trillion to more than $7 trillion, and included the first purchases of corporate bond exchange-traded funds. The target federal funds rate remains in the 0%-0.25% range.
- U.S. gross domestic product (GDP) fell 5.0% in the first quarter of 2020. Second-quarter GDP is poised to fall much further even as many states begin to rollback "stay at home" measures. Consumer spending and confidence experienced record drops, but early signs of a bottoming have emerged.
- The May U.S. Bureau of Labor Statistics (BLS) labor market report showed that the economy defied expectations for massive job losses and instead added 2.5 million jobs. The unemployment rate fell to 13.3% from 14.7%, which was a post-WWII high. However, many economists doubt that this is a full measure of the status of the jobs market, and the BLS noted that classification errors understated the true rate by about 3%. The number of Americans that have applied for unemployment benefits during the pandemic now exceeds 40 million, and about six million have left the job market since the downturn began.
- ISM Manufacturing and Services PMI surveys rebounded marginally to 43.1 and 45.4, respectively, but remain in contraction territory. Meanwhile, the housing market has held up reasonably well amid low supply.

Bond Markets

- The U.S. Treasury yield curve steepened in the month as yields on maturities from two to five years fell modestly, while 20- and 30-year bond yields rose about 13 basis points (bps).
- For the month, the 2-year and 5-year Constant Maturity U.S. Treasury Indices returned 0.07% and 0.20%, while the 10-year index returned -0.02%.
- A strong surge in corporate issuance was easily digested by robust demand. Yield spreads on investment-grade (IG) corporate bonds continued to decline. By month-end, spreads had retraced about 80% of their widening spike in March. This tightening led to strong performance for the month, with year-to-date returns nearly closing the huge first-quarter performance gap versus Treasuries.

Equity Markets

- U.S. equities cast aside grim economic data amid optimism about a quicker-than-expected recovery. Country-wide protests, staggering unemployment, contraction in manufacturing activity and even renewed tensions between the U.S. and China failed to deter the strong rally from March's lows. In May, the S&P 500 advanced 4.5%; the NASDAQ surged 6.8% and the Dow gained 4.3%.
- Developed market equities also rose sharply, nearly matching the U.S. recovery. Emerging markets lagged as investors assessed their capacity to deal with the economic and health crises. The U.S. Dollar Index pulled back 0.6% over the month.

PFM Outlook

- Balancing the realities of a severe and uncertain economic downturn against the massive and historic support by the Fed and other fiscal authorities supported a benchmark-neutral duration strategy. Since the Fed committed to low rates for the foreseeable future, we believe this continues to be the appropriate strategy and plan to rebalance portfolios as necessary to match index duration extensions.
- In the federal agency sector, the continued value in the form of elevated spreads afforded the opportunity to add to agency allocations at attractive levels, most notably in maturities beyond three years. Conversely, the supranational sector experienced fewer new issues and dwindling opportunities.
- IG corporate yield spreads are much tighter, but still offer value relative to historical norms. Liquidity also improved dramatically over the past two months and investor appetite is strong. As a result of improved trading conditions, backstopped by the Fed's new purchase program, PFM felt more comfortable increasing corporate allocations through selective purchases. We did this with a heightened level of scrutiny into each issuer's industry position and balance sheet strength. New allocations focused on high-quality issuers where valuations remained attractive compared to pre-crisis levels.
- Similar to the corporate sector, the Fed's commitment to supporting the mortgage-backed securities (MBS) sector reduced volatility and helped turn the tide of widening spreads. As the sector stabilized, PFM identified the emerging trend as an opportunity to add to MBS allocations. Our preferred structures include those with lesser prepayment risks and favorable stress test results.
- After pausing all asset-backed securities (ABS) purchases since March, we saw stability return to this sector, and we beganto re-enter the ABS market cautiously.
- In short-term markets, huge Treasury bill issuance pushed bill yields higher. At the same time, commercial paper yields collapsed to within 10-15 bps of Treasury bills, completely reversing the brief, crisis-induced sell-off in March and suppressing the value of money market instruments.

U.S. Treasury Yields

Duration	May 31, 2019	Apr 30, 2020	May 31, 2020	Monthly Change
3-Month	2.34%	0.10%	0.14%	0.04%
6-Month	2.35%	0.11%	0.16%	0.05%
2-Year	1.92%	0.20%	0.16%	-0.04%
5-Year	1.91%	0.36%	0.30%	-0.06%
10-Year	2.13%	0.64%	0.65%	0.01%
30-Year	2.57%	1.29%	1.41%	0.12%

Yields by Sector and Maturity as of May 31, 2020

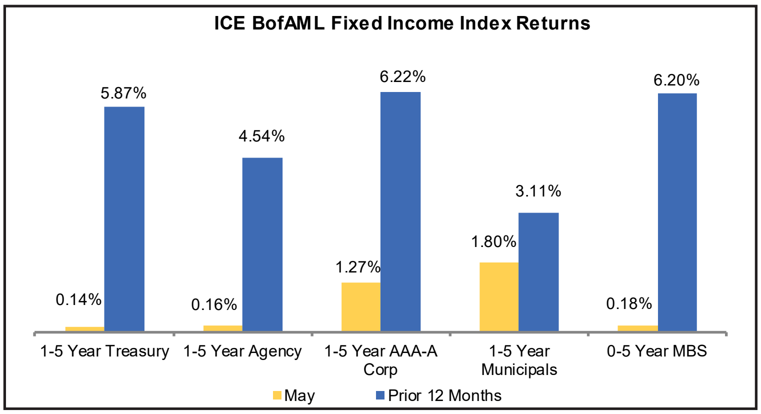
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	0.14%	0.12%	0.45%	--
6-Month	0.16%	0.13%	0.47%	--
2-Year	0.16%	0.21%	0.55%	0.37%
5-Year	0.30%	0.50%	1.00%	0.68%
10-Year	0.65%	1.02%	1.86%	1.29%
30-Year	1.41%	1.75%	2.97%	1.91%

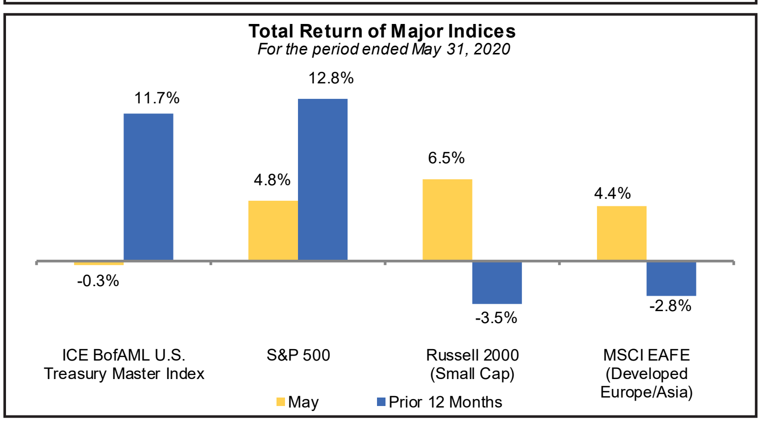
Spot Prices and Benchmark Rates

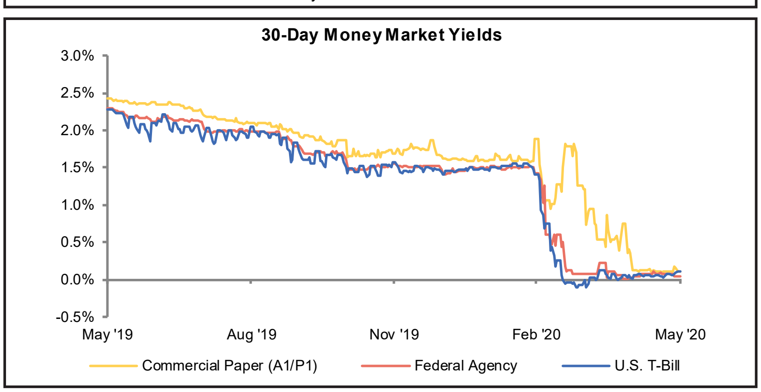
Index	May 31, 2019	Apr 30, 2020	May 31, 2020	Monthly Change
1-Month LIBOR	2.43%	0.33%	0.18%	-0.15%
3-Month LIBOR	2.50%	0.56%	0.34%	-0.22%
Effective Fed Funds Rate	2.40%	0.05%	0.05%	0.00%
Fed Funds Target Rate	2.50%	0.25%	0.25%	0.00%
Gold ($/oz)	$1,306	$1,694	$1,737	$43
Crude Oil ($/Barrel)	$53.50	$18.84	$35.49	$16.65
U.S. Dollars per Euro	$1.12	$1.10	$1.11	$0.01

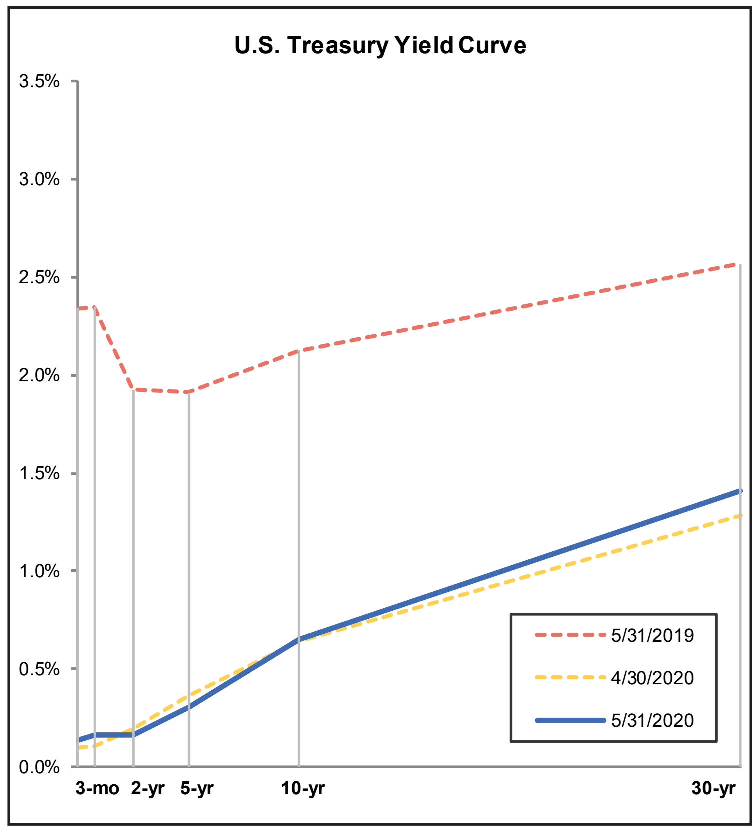
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Consumer Confidence	26-May	May	86.6	87.0
GDP Annualized QoQ	28-May	1Q S	-5.0%	-4.8%
PCE Core Deflator YoY	29-May	Apr	1.0%	1.1%
FOMC Rate Decision (Upper)	1-Jun	May	43.1	43.8
Non-farm Payrolls	5-Jun	May	13.3%	19.0%
Unemployment Rate	11-Jun	May 30	20,929k	20,000k
ISM Manufacturing	16-Jun	May	17.7%	8.4%









Source: Bloomberg. Data as of May 31, 2020, unless otherwise noted.

The views expressed constitute the perspective of PFM Asset Management LLC at the time of distribution and are subject to change. The content is based on sources generally believed to be reliable and available to the public; however, PFM cannot guarantee its accuracy, completeness or suitability. This material is for general information purposes only and is not intended to provide specific advice or a specific recommendation. PFM is the marketing name for a group of affiliated companies providing a range of services. All services are provided through separate agreements with each company. Investment advisory services are provided by PFM Asset Management LLC, which is registered with the SEC under the Investment Advisers Act of 1940. For more information regarding PFM's services or entities, please visit www.pfm.com.