Fixed Income | September 2021

Monthly Market Review

"Economic clouds thicken as markets remain resilient."

Economic Highlights

- The rising summer tide of coronavirus infections seems to have drowned out optimism about the economic recovery. Daily cases have risen to levels not seen since the beginning of the year, and vaccination rates have slowed at a time when relief from the Federal government is subsiding. As the summer ends, a COVID-weary country may face a distressing reality check.
- Consumers tightened their purse strings as COVID-19 Delta variant concerns and renewed public health restrictions clouded financial prospects. Headline retail sales fell 1.1% in July.
- The economy added only 235,000 jobs in August, falling far short of economists' estimates of 735,000 jobs and the weakest posting since January. It appears that potential workers have pulled back from the labor force because of renewed COVID-19 concerns. Although the unemployment rate fell to 5.2% from 5.4%, the labor force participation rate remained 1.6% below pre-pandemic levels. The number of persons unable to work because their employer closed or lost business due to the pandemic rose. A bright spot in the labor market reports is that average hourly earnings rose 4.3% over the past year.
- Supply-chain challenges, rising commodity costs, and materials and labor shortages are now weighing on business conditions. Surveys of purchasing managers for August signaled slowing manufacturing and services activity, albeit both still expansionary.
- At the annual Jackson Hole symposium on monetary policy, Federal Reserve (Fed) Chair Jerome Powell said the tapering of asset purchases could begin this year as the U.S. economy recovers from the pandemic, but the central bank will not be in a hurry to raise interest rates. He also reiterated the Fed's belief that the current spike in inflation is likely to be transitory.

Bond Markets

- Treasury yields generally rose during August, with those on maturities between five and 10 years jumping by six to nine basis points (bps). However, the 10-year Treasury note yield ended August 44 bps below its spring peak, reflecting a more sanguine view about inflation, longer-term economic growth prospects, and a patient Fed.
- The U.S. Treasury continued to issue new bonds to fund the deficit, but monthly volume has been steady through the year. Reductions are likely later this year as Federal fiscal stimulus costs wane. Issuance may also be disrupted by the expiration of the debt limit suspension, which will prevent increased issuance until the limit is extended, and then likely result in a flood to make up for lost capacity.
- Indicative of the surfeit of cash in the short-term markets, usage of the Fed's Reverse Repo Facility has remained above $1 trillion per day since mid-August. In fact, it may become necessary for the Fed to raise its per-counterparty limit to add capacity and keep overnight rates above true zero.
- Returns on Treasury indices were generally negative for the month as yields rose across most maturities. The 5- and 10-year Treasury indices returned -0.2% and -0.3%, respectively.

Equity Markets

- U.S. equity markets marched to new record highs – August 30, 2021 marked the 53rd new high this year for the S&P 500 – despite growing risks to the outlook. Equities shrugged off concerns about rising coronavirus infections, supply-chain challenges, materials shortages, Fed tapering uncertainty and a messy pullout from Afghanistan. The S&P 500 rose 3.0% in August, which marked the seventh consecutive month of gains. The Nasdaq returned 4.1%, while the Dow Jones Industrial Average returned 1.5%.
- Developed market equities (represented by the MSCI ACWI ex-USA Index) continued to lag U.S. equity indices, posting a return of 1.9% for August. The U.S. Dollar Index (DXY) appreciated 0.5% in August. The movement of the U.S. dollar against a basket of currencies has rebounded from near multi-year lows since May, putting a drag on non-U.S. economies that export goods and services to the U.S.

PFM Strategy Recap

- The economic outlook has gotten a bit more cloudy as rising COVID-19 cases and increased public health restrictions may slow consumer spending and ultimately economic growth. Meanwhile, the Fed is on track to begin tapering in the next several months, but any rate increases are far off into the future. Given this balance of factors, we plan to maintain a generally neutral duration stance relative to market benchmarks.
- No surprise, federal agency spreads remain tight. Issuance has been light and opportunities are limited.
- Investment-grade (IG) corporate spreads are ever-so-slightly elevated compared to mid-year tights. Trends in corporate fundamentals are encouraging, but overall valuations remain very rich. New issues continue to be the best avenue for sourcing opportunities.
- AAA-rated asset-backed securities (ABS) spreads are stable near-record tights. The sector offers fair value relative to corporates, with shorter structures (one-year average life) offering the best relative value.
- Mortgage-backed securities (MBS) spreads are slightly wider from second quarter rock bottoms. However, with spreads still well below long-term averages and Fed tapering looming, the sector remains at risk for underperformance.
- Holding excess cash is costly as short-term yields remain very low. Commercial paper and bank CDs offer some value, especially in longer (9-12 month) maturities.

U.S. Treasury Yields

Duration	Aug 31, 2020	Jul 31, 2021	Aug 31, 2021	Monthly Change
3-Month	0.10%	0.04%	0.04%	0.00%
6-Month	0.11%	0.05%	0.05%	0.00%
2-Year	0.13%	0.19%	0.21%	0.02%
5-Year	0.27%	0.69%	0.78%	0.09%
10-Year	0.71%	1.22%	1.31%	0.09%
30-Year	1.48%	1.89%	1.93%	0.04%

Yields by Sector and Maturity as of August 31, 2021

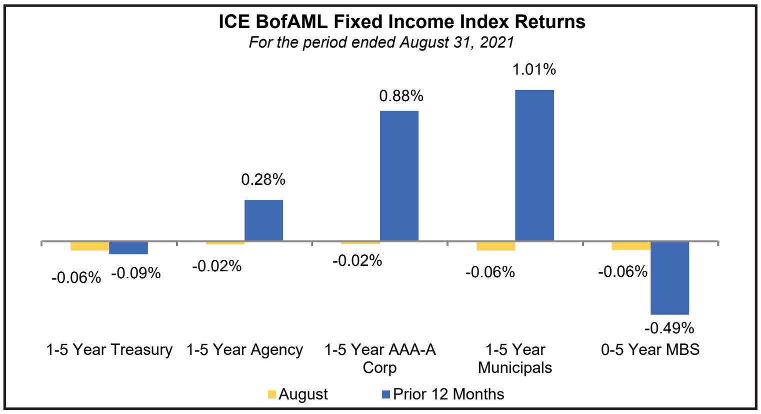
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	0.04%	0.03%	0.15%	--
6-Month	0.05%	0.03%	0.17%	--
2-Year	0.21%	0.20%	0.34%	0.09%
5-Year	0.78%	0.79%	1.10%	0.41%
10-Year	1.31%	1.41%	1.94%	1.16%
30-Year	1.93%	1.91%	2.80%	1.72%

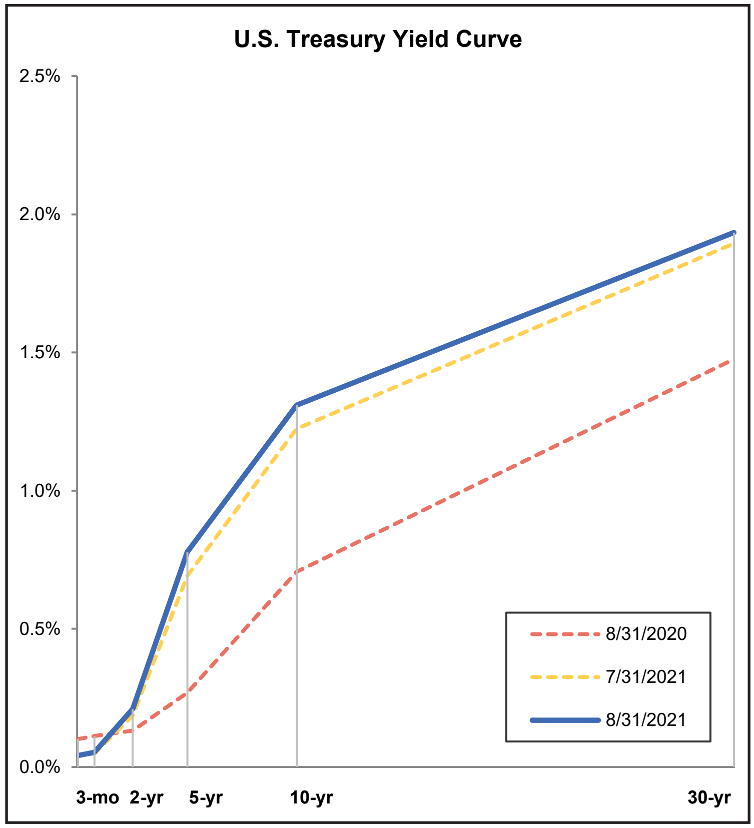
Spot Prices and Benchmark Rates

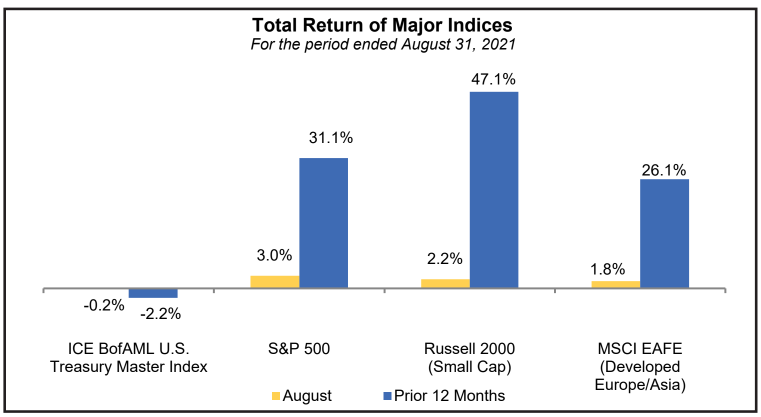
Index	Aug 31, 2020	Jul 31, 2021	Aug 31, 2021	Monthly Change
1-Month LIBOR	0.16%	0.09%	0.08%	-0.01%
3-Month LIBOR	0.24%	0.12%	0.12%	0.00%
Effective Fed Funds Rate	0.09%	0.07%	0.06%	-0.01%
Fed Funds Target Rate	0.25%	0.25%	0.25%	0.00%
Gold ($/oz)	$1,971	$1,813	$1,816	$3
Crude Oil ($/Barrel)	$42.61	$73.95	$68.50	-$5.45
U.S. Dollars per Euro	$1.19	$1.19	$1.18	-$0.01

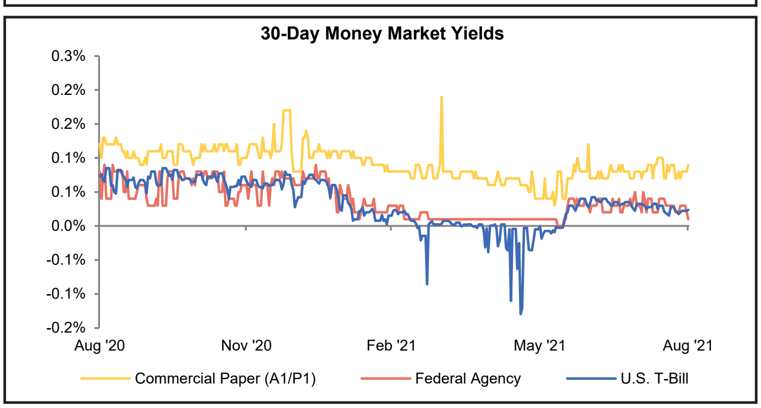
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales Advance MoM	17-Aug	Jul	-1.1%	-0.3%
GDP Annualized QoQ	26-Aug	2Q S	6.6%	6.7%
PCE Core Deflator YoY	27-Aug	Jul	3.6%	3.6%
Consumer Confidence	31-Aug	Aug	113.8	123.0
ISM Manufacturing	1-Sep	Aug	59.9	58.5
Change in Non-Farm Payrolls	3-Sep	Aug	235k	733k
Unemployment Rate	3-Sep	Aug	5.2%	5.4%









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

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