Monthly Market Review

Fixed Income | May 2024

pfm asset management

"Yields Pop and Stocks Drop"

Economic Highlights

► The market's expectations for the number of rate cuts from the Federal Reserve (Fed) fell during April due to inflation readings coming in above expectations and hawkish Fed commentary. After the May Federal Open Market Committee (FOMC) meeting — during which the Fed left the range for the overnight target rate unchanged at 5.25% to 5.50% — Fed Chair Jerome Powell noted that it is likely going to take longer than previously expected for the Fed to gain greater confidence that inflation is moving sustainably lower towards its 2% target. The market reaction was tempered by the fact that Chair Powell indicated an additional rate hike was unlikely.

► The trend of hotter-than-expected inflation readings continued in April. The Consumer Price Index (CPI) exceeded estimates for the third consecutive month as the year-over-year (YoY) change rose to 3.5%, the highest level since September. PCE also rose for the first time in five months, increasing to 2.7%. The YoY change in Core PCE (which excludes volatile food and energy components) was unchanged from the prior month at 2.8%, ending the recent run of 14 consecutive monthly declines.

► The April jobs report pointed to the labor market continuing to settle into equilibrium. The nonfarm payrolls report came in below expectations and fell to 175,000 but is still above the level necessary to keep pace with population growth. The unemployment rate also ticked up to 3.9% but has remained below 4% for 27 consecutive months, which is the longest such streak since the 1960s. Yields declined on the news as the market interpreted the data as evidence that the hot labor market may be starting to normalize.

► The advance estimate for Q1 real gross domestic product (GDP) came in at 1.6%, which was materially lower than the 3.4% reading in Q4 and almost a full percentage point below survey expectations. Markets were largely unfazed by the cooler-than-expected growth as personal consumption remained strong and detractors from GDP growth were in the more volatile components, such as net exports and inventories.

► Elevated price levels — particularly for gas and food — continue to be a drag on consumers as the April Consumer Confidence Index touched a nearly two-year low.

► The ISM Services Index showed the services sector contracted in April, which was the first time it has contracted since December 2022. The ISM Manufacturing Index also showed the sector returning to contraction in April after briefly expanding in the prior month. The sector continues to show weakness and has now contracted for 17 of the last 18 months.

Bond Markets

► U.S. Treasury yields between 2- and 30-years finished the month up 42 to 50 basis points (bps) following a broad repricing given sticky inflation and hawkish Fed speak.

► The yield curve remains deeply inverted. Short-term yields (less than one year) moved negligibly higher during the month.

► The yields on benchmark 2-, 5-, and 10-year U.S. Treasuries ended the month at 5.04%, 4.72%, and 4.68%, respectively, representing changes of +42, +50, and +48 bps for the month, respectively.

► As a result of large month-over-month increases in yield across the curve, income returns were outweighed by the rate-induced prices declines. The ICE BofA 2-, 5-, and 10-year Treasury indices returned -0.39%, -1.82%, and -3.37%, respectively.

Equity Markets

► Equity markets slid from all-time highs as the higher-for-longer Fed sentiment diminished equity appetite. April marked the worst month for equities since September 2023 as the S&P 500 Index ended the month down 4.1%. The Dow Jones Industrial Average and NASDAQ similarly fell by 4.9% and 4.4%, respectively. International equites (as measured by the MSCI ACWI ex U.S.) outperformed despite declining by 1.6% for the month.

► The dollar index (DXY) moved higher by 1.7% in April as the Fed's hawkish tone roiled markets. The stronger dollar also played a modest role in the underwhelming Q1 GDP results as net exports detracted by -0.86%.

PFMAM Strategy Recap

► Fed guidance has pointed to rates staying higher-for-longer as the Fed remains committed to restoring inflation to its long-term target of 2%. As such, yields are likely at or near cycle highs and we expect the general trend will be for lower interest rates over the next several quarters as an eventual Fed cut approaches. As a result, we plan to maintain neutral portfolio durations relative to benchmarks.

► Spreads on federal agencies and supranationals remain tight and offer limited value while issuance remains quiet.

► Investment-grade (IG) corporate bonds showed positive excess returns for the sixth consecutive month as spreads continued to narrow. Issuance has slowed from the record pace in Q1 but may offer some opportunities relative to secondary markets. With portfolio allocations still near historically high levels and spreads near recent lows, we believe it is a prudent time to opportunistically trim rich holdings through active selling or attrition in search of better relative value opportunities.

► Asset-backed securities (ABS) continued to perform well as spreads moved tighter. Valuations have normalized and are back in line with long-term averages. As a result, we will likely look to allow the natural wind down of portfolio holdings to reduce allocations.

► Mortgage-backed securities (MBS) firmly underperformed in April on the back-up in U.S. Treasury yields, while agency-backed CMBS continued to generate positive excess returns. Given the significant recent underperformance and spread-widening in 30-year mortgage-related securities, we will likely begin to modestly add back to this portion of the sector.

► Short-term money markets have moved higher over the month following the repricing of rate cuts. Short-term credit spreads have also moved wider and issuers re-entered the market post-quarter end. Commercial paper and negotiable bank CDs present opportunity for short-term investors.

U.S. Treasury Yields

Duration	Apr 30, 2023	Mar 31, 2024	Apr 30, 2024	Monthly Change
3-Month	5.06%	5.37%	5.40%	0.03%
6-Month	5.02%	5.32%	5.40%	0.08%
2-Year	4.01%	4.62%	5.04%	0.42%
5-Year	3.49%	4.21%	4.72%	0.51%
10-Year	3.43%	4.20%	4.68%	0.48%
30-Year	3.68%	4.34%	4.79%	0.45%

Yields by Sector and Maturity

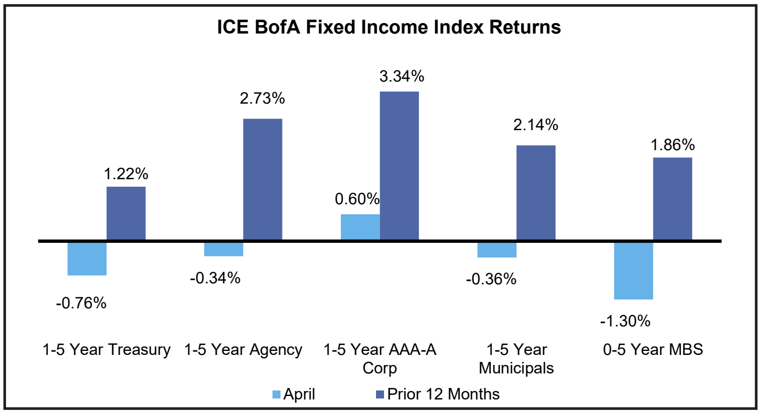
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	5.40%	5.41%	5.59%	-
6-Month	5.40%	5.40%	5.64%	-
2-Year	5.04%	5.05%	5.30%	3.18%
5-Year	4.72%	4.73%	5.24%	2.81%
10-Year	4.68%	4.74%	5.45%	2.86%
30-Year	4.79%	-	5.73%	3.97%

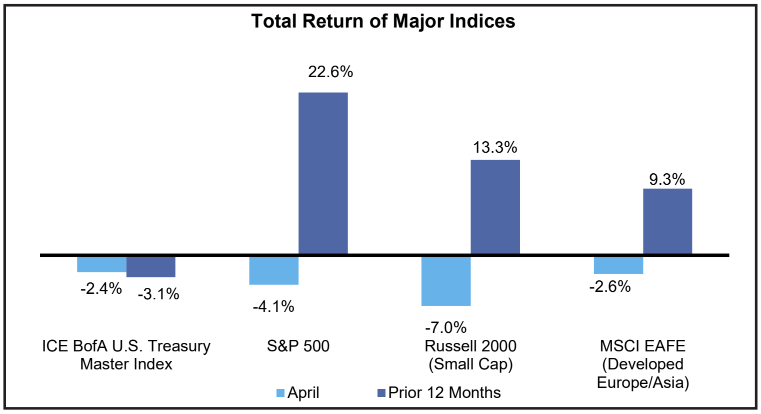
Spot Prices and Benchmark Rates

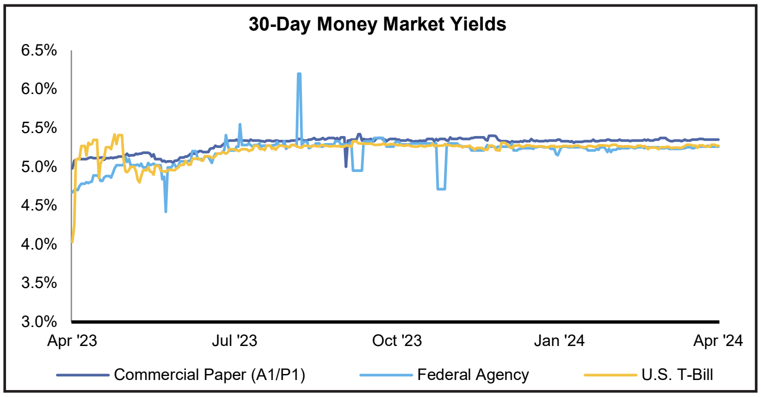
Index	Apr 30, 2023	Mar 31, 2024	Apr 30, 2024	Monthly Change
1-Month LIBOR	5.06%	5.44%	5.43%	-0.01%
3-Month LIBOR	5.30%	5.56%	5.59%	0.03%
Effective Fed Funds Rate	4.83%	5.33%	5.33%	0.00%
Fed Funds Target Rate	5.00%	5.50%	5.50%	0.00%
Gold ($/oz)	$1,999	$2,217	$2,303	$86
Crude Oil ($/Barrel)	$76.78	$83.17	$81.93	-$1.24
U.S. Dollars per Euro	$1.10	$1.08	$1.07	-$0.01

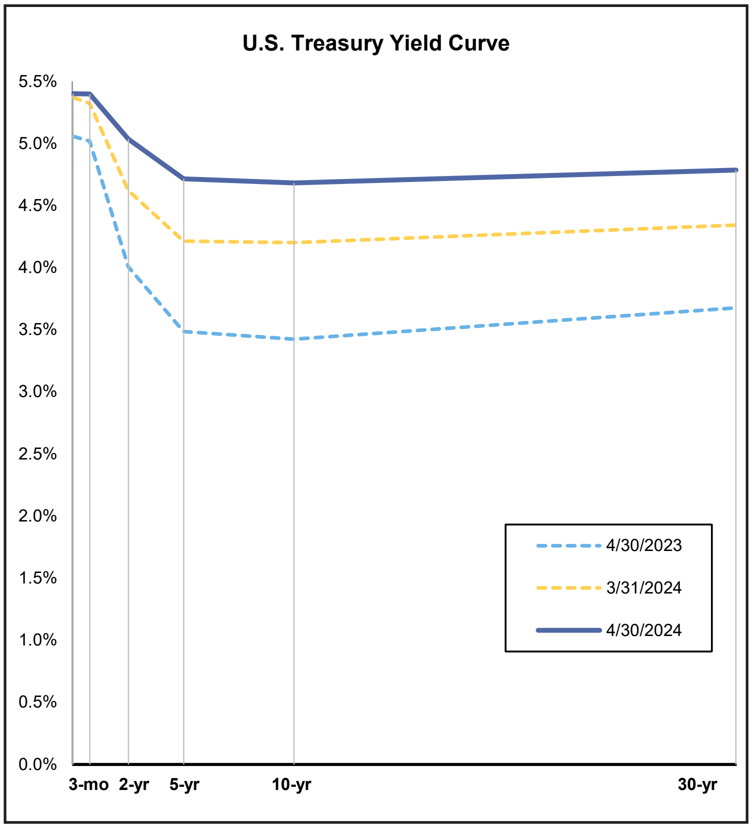
Economic Indicators

Indicator	Release Date	Period	Actual	"Survey (Median)"
Change in Nonfarm Payrolls	5-Apr	Mar	303K	214K
CPI YoY	10-Apr	Mar	3.50%	3.40%
Existing Home Sales MoM	18-Apr	Mar	-4.30%	-4.10%
GDP Annualized QoQ	25-Apr	1Q A	1.60%	2.50%
U. of Mich. Consumer Sentiment	26-Apr	Apr F	77.2	77.9
PCE YoY	26-Apr	Mar	2.70%	2.60%
FOMC Rate Decision	1-May	May	5.50%	5.50%









Source: Bloomberg. Data as of April 30, 2024, unless otherwise noted.

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