BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

CHANDLER ASSET MANAGEMENT

AUGUST 2022

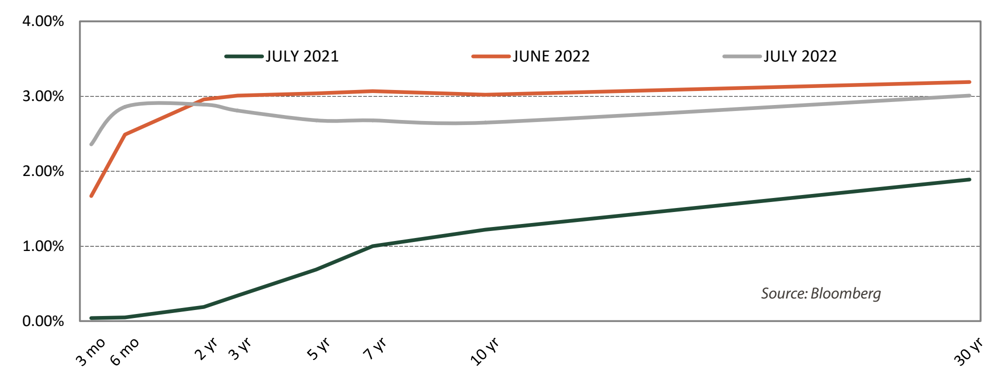
Market Summary

Tightening financial conditions and higher interest rates continue to adversely impact the trajectory of the US and global economy. Inflation is weighing heavily on consumer sentiment and beginning to impact discretionary spending. Labor markets remain strong, but wage gains are not keeping up with inflation. While we expect the Fed to continue to tighten monetary policy, evidence of slower economic conditions has begun to mount. Over the near-term, we expect financial market volatility to remain intensified and conditions to remain tighter with persistent inflation, geopolitical risk, supply chain bottlenecks, and the Fed's shift to a more hawkish monetary policy.

At the July meeting, the Federal Open Market Committee (FOMC) delivered another 75-basis point increase to the Fed Funds Rate, increasing the range from 2.25% to 2.50%. The FOMC acknowledged spending and production were trending lower, offset by a strong labor market and elevated inflation metrics. Fed Chair Powell declining to provide forward guidance, but acknowledged current policy settings are close to neutral but emphasized policy would need to move to a more restrictive stance to counterbalance the elevated inflation trends. We anticipate additional hikes across rates as the Fed remains focused on lowering inflation.

In July, yields fell and the curve inverted. The 2-year Treasury yield declined 7 basis points to 2.89%, the 5-year Treasury yield plunged 36 basis points to 2.68%, and the 10-year Treasury yield dropped 37 basis points to 2.65%. The spread between the 2-year Treasury yield and 10-year Treasury yield inverted to -24 basis points at July month-end versus 6 basis points at June month-end, and 104 basis points one year ago. The spread between 3-month and 10-year treasuries compressed to just 29 basis points. The shape of the curve does not necessarily indicate an imminent recession but bears watching as a better predictor of recession over the medium-term.

Treasury Yields Fell in July



At the end of July, the 2-year Treasury yield was 270 basis points higher, and the 10-Year Treasury yield was about 143 basis points higher, year-over-year. The spread between the 2-year Treasury yield and 10-year Treasury yield inverted to -24 basis points at July month-end versus 6 basis points at June month-end. The average historical spread (since 2003) is about 130 basis points. The spread between 3-month and 10-year treasuries compressed to just 29 basis points. The shape of the yield curve does not indicate an imminent recession but bears watching as a better predictor of recession over the medium-term.

TREASURY YIELDS	Trend (▲/▼)	7/29/2022	6/30/2022	Change
3-Month	▲	2.36	1.67	0.70
2-Year	▼	2.89	2.96	-0.07
3-Year	▼	2.81	3.01	-0.20
5-Year	▼	2.68	3.04	-0.36
7-Year	▼	2.68	3.07	-0.39
10-Year	▼	2.65	3.02	-0.37
30-Year	▼	3.01	3.19	-0.17

Source: Bloomberg

Market Data

World Stock Market Indices
data as of 7/29/2022

		Change (6/30/2022)	%CHG
S&P 500	**4,130.29**	344.91	9.11%
NASDAQ	**12,390.69**	1,361.95	12.35%
DOW JONES	**32,845.13**	2,069.70	6.73%
FTSE (UK)	**7,423.43**	254.15	3.54%
DAX (Germany)	**13,484.05**	700.28	5.48%
Hang Seng (Hong Kong)	**20,156.51**	-1,703.28	-7.79%
Nikkei (Japan)	**27,801.64**	1,408.60	5.34%

Source: Bloomberg. Please see descriptions of indices on Page 2.

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Since 1988, Chandler Asset Management has specialized in providing fixed income investment solutions to risk-averse public agencies and institutions. Chandler's mission is to provide fully customizable client-centered portfolio management that preserves principal, mitigates risk, and generates income in our clients' portfolios.

Credit Spreads tightened in July

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top rated commercial paper	0.46	0.65	(0.19)
2-year A corporate note	0.41	0.58	(0.16)
5-year A corporate note	0.85	0.95	(0.10)
5-year Agency note	0.18	0.15	0.03

Source: Bloomberg

Data as of 7/29/2022

Inflationary Pressures Continue to Impact Economic Data

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(79.61) $Bln JUN 22	(84.91) $Bln MAY 22	(71.36) $Bln JUN 21
Gross Domestic Product	(0.90%) JUN 22	(1.60%) MAR 21	6.70% JUN 21
Unemployment Rate	3.50% JUL 22	3.60% JUN 22	5.40% JUL 21
Prime Rate	5.50% JUL 22	4.75% JUN 22	3.25% JUL 21
Refinitiv/CoreCommodity CRB Index	292.06 JUL 22	291.15 JUN 22	218.08 JUL 21
Oil (West Texas Int.)	$98.62 JUL 22	$105.76 JUN 22	$73.95 JUL 21
Consumer Price Index (y/o/y)	8.50% JUL 22	9.10% JUN 22	5.40% JUL 21
Producer Price Index (y/o/y)	18.60% JUN 22	16.70% MAY 22	9.70% JUN 21
Euro/Dollar	1.02 JUL 22	1.05 JUN 22	1.19 JUL 21

Source: Bloomberg

Economic Roundup

Consumer Prices

The Consumer Price Index (CPI) slowed in July, reflecting lower energy prices but annual inflation remains high as food costs continue to rise. Headline CPI was up 8.5% from a year earlier, from the 9.1% reading June. Weaker gasoline prices offset increases in the cost of food and shelter. Gasoline prices fell 7.7% in July, the most since April 2020, after rising 11.2% a month earlier while food costs climbed 10.9% from a year ago, the most since 1979. Shelter costs, the largest component of CPI, contributing about a third of the overall index, rose 0.5% from June and 5.7% from last year, the most since 1991. Core CPI which excludes the more volatile food and energy components, rose 0.3% and 5.9% from a year ago. The Personal Consumption Expenditures (PCE) index was up 6.8% year-over-year in June, up from a 6.3% year-over-year increase in May. Core PCE was up 4.8% year-over-year in June, versus up 4.7% year-over-year in May. Persistently elevated inflation is likely to keep the Federal Reserve on the path of tightening monetary policy if it continues to run well above the Fed's longer-run target of around 2.0%

Retail Sales

Retail sales rose 1.0% in June from an upwardly revised -0.1% in May, led by a significant dollar value increase in gasoline sales. The higher-than-expected results indicate consumer demand is holding up more than expected despite inflation. Retail sales growth is at risk as consumers dip into savings and assume more debt. On a year-over-year basis, retail sales were up 8.4% in June versus up 8.2% revised in May. The Consumer Confidence index fell to 95.7 in July from a downwardly revised 98.4 in June. Consumers' buying plans for major purchases have waned coinciding with higher interest rates and stock market declines. In addition, discretionary spending decisions are increasingly pressured by elevated gas, food, and shelter costs.

Labor Market

The U.S. economy added 528,000 jobs in July, more than double market expectations of 250,000, and job gains were revised up by 28,000 for the prior two months. Trends in employment remain strong, with the three-month moving average payrolls at 437,000 and the six-month moving average at 465,000. Hiring was widespread, led by leisure and hospitality, professional and business services, and healthcare. The unemployment rate dipped to 3.5%, returning to its pre-pandemic level, as the labor participation rate decreased to 62.1% from 62.2% in June. The U-6 underemployment rate, which includes those who are marginally attached to the labor force and employed part time for economic reasons remained steady at 6.7%. Average hourly earnings rose 5.2% in July from 5.1% year-over-year in June, adding to broader inflationary pressures in the economy. The strong July labor report bolsters the case for the Fed to continue raising the federal funds rate.

Housing Starts

Total housing starts declined 2.0% to an annual rate of 1,559,000 in June, from a revised 1,591,000 in units in May. Single-family home starts fell by 8.1% and multi-family increased 10.3% month-over-month. On a year-over-year basis, total housing starts decreased 6.3%, driven by a drop in construction of single-family houses as homebuyers struggle with a combination of elevated prices and higher mortgage rates. According to the Case-Shiller 20-City home price index, home prices were up 20.5% year-over-year in May, easing slightly from a 21.2% year-over-year increase in April. The rate of home price increases will likely decelerate as the year progresses due to the substantial rise in mortgage rates and the negative performance of financial markets.

World Stock Market Index Descriptions

S&P 500– The S&P 500 is a market value-weighted index of 500 large-capitalization stocks. The 500 companies included in the index capture approximately 80% of available US market capitalization. NASDAQ–The NASDAQ Composite Index is the market capitalization-weighted index of over 3.300 common stocks listed on the NASDAQ stock exchange. Dow Jones–The Dow Jones Industrial Average is an index that tracks 30 large, publicly-owned companies trading on the New York Stock Exchange and the NASDAQ. The Financial Times Stock Exchange Group (FTSE)– The FTSE is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalization. DAX–The Deutscher Aktienindex (DAX) is a blue chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. Hang Seng–The Hang Seng Index is a freefloat-adjusted market-capitalization-weighted stock market index in Hong Kong. It is used to record and monitor daily changes of the largest companies of the Hong Kong stock market and is the main indicator of overall market performance in Hong Kong. Nikkei–Japan's Nikkei 225 Stock Average is a price-weighted index composed of Japan's top 225 blue-chip companies traded on the Tokyo Stock Exchange.