CHANDLER ASSET MANAGEMENT

BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

FEBRUARY 2023

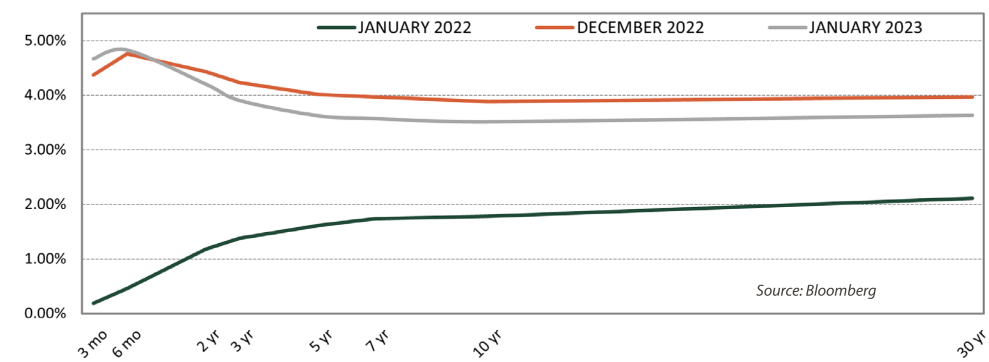
Market Summary

Market volatility has intensified as investors weigh the probabilities of a hard or soft economic landing. The strong labor market has helped sustain economic growth. Inflation metrics are trending downward but remain significantly higher than the Federal Reserve's target. Financial conditions have eased, and credit spreads have narrowed over the last quarter. Geopolitical risks remain as the Russia/Ukraine war persists and China reopens, while domestically the debt ceiling risk has emerged. As uncertainty has grown, the consensus market view has diverged from the Federal Reserve's projected rate path. While evidence of slower economic conditions has begun to mount, we believe the Federal Reserve will continue to tighten monetary policy at a slower pace and remain restrictive for some time, and uncertainty will continue to fuel market volatility.

As expected at the February 1st meeting, the Federal Open Market Committee (FOMC) raised the fed funds target rate by 25 basis points to a range of 4.50 - 4.75%, in a continuing downshift from previous hikes. The decision was unanimous, and the statement reflects inflation is easing "somewhat." The sentiment was hawkish, indicating that the extent of "ongoing increases" in the fed funds rate will be data dependent. We believe the FOMC will continue to implement tighter monetary policy at a slower pace and hold rates at restrictive levels for some time until inflationary pressures subside and remain in the Fed's target range.

US Treasury yields fell in January. The 2-year Treasury yield decreased 23 basis points to 4.20%, the 5-year Treasury yield decreased 39 basis points to 3.62%, and the 10-year Treasury yield declined 37 basis points to 3.51% as the US economy showed signs of slowing and the Fed reduced the magnitude of interest rate hikes. The year 2022 saw a dramatic shift in the Federal Reserve's policy from highly accommodative to aggressive tightening, resulting in significantly higher rates and an inverted yield curve.

Treasury Yields Decreased in January



In January, the yield curve inversion widened. The 2-year Treasury yield decreased 23 basis points to 4.20% and the 10-year Treasury yield declined 37 basis points to 3.51%. The inversion between the 2-year Treasury yield and 10-year Treasury yield increased to -69 basis points at January month-end versus -55 basis points at December month-end. The average historical spread (since 2003) is about +130 basis points. The inversion between 3-month and 10-year Treasuries increased to -115 basis points in January from -50 basis points in December. The shape of the yield curve indicates that the probability of recession is increasing but recent economic data remains above recessionary levels .

TREASURY YIELDS	Trend (▲/▼)	01/31/2023	12/31/2022	Change
3-Month	▲	4.67	4.37	0.29
2-Year	▼	4.20	4.43	-0.23
3-Year	▼	3.90	4.23	-0.33
5-Year	▼	3.62	4.01	-0.39
7-Year	▼	3.57	3.97	-0.40
10-Year	▼	3.51	3.88	-0.37
30-Year	▼	3.63	3.97	-0.33

Source: Bloomberg

Market Data

World Stock Market Indices
data as of 01/31/2023

	Change (12/31/2022)	%CHG
S&P 500		
4,076.60	237.10	6.18%
NASDAQ		
11,584.55	1,118.07	10.68%
DOW JONES		
34,086.04	938.79	2.83%
FTSE (UK)		
7,771.70	319.96	4.29%
DAX (Germany)		
15,128.27	1,204.68	8.65%
Hang Seng (Hong Kong)		
21,842.33	2,060.92	10.42%
Nikkei (Japan)		
27,327.11	1,232.61	4.72%

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 January

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top rated commercial paper	0.13	0.25	(0.12)
2-year A corporate note	0.38	0.45	(0.06)
5-year A corporate note	0.79	0.84	(0.04)
5-year Agency note	0.20	0.13	0.06

Source: Bloomberg Data as of 01/31/2023

Inflation Remains Above the Federal Reserve's Target But Recent Numbers have been Constructive

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(67.42) $Bln DEC 22	(61.02) $Bln NOV 22	(78.87) $Bln DEC 21
Gross Domestic Product	2.90% DEC 22	3.20% SEP 22	7.00% DEC 21
Unemployment Rate	3.40% JAN 23	3.50% DEC 22	4.00% JAN 22
Prime Rate	7.75% FEB 23	7.50% JAN 23	3.25% FEB 22
Refinitiv/CoreCommodity CRB Index	278.09 JAN 23	277.75 DEC 22	255.12 JAN 22
Oil (West Texas Int.)	$78.87 JAN 23	$80.26 DEC 22	$88.15 JAN 22
Consumer Price Index (y/o/y)	6.40% JAN 23	6.50% DEC 22	7.50% JAN 22
Producer Price Index (y/o/y)	9.00% DEC 22	10.70% NOV 22	12.30% DEC 21
Euro/Dollar	1.09 JAN 23	1.07 DEC 22	1.12 JAN 22

Source: Bloomberg

Economic Roundup

Consumer Prices

The Consumer Price Index (CPI) increased at a rate of 6.4% year-over-year in January versus up 6.5% in December bolstered by energy and shelter costs. The Core CPI, which excludes volatile food and energy components increased 5.6% year-over-year in January, down from a rate of 5.7% in December. The Federal Reserve's preferred measure of inflation, the Personal Consumption Expenditures (PCE) index rose 5.0% year-over-year in December versus a 5.5% year-over-year gain in November. Core PCE increased 4.4% year-over-year in December versus a 4.7% year-over-year gain in November. Declining inflationary trends are expected to provide the Federal Reserve room to reduce the pace and magnitude of future federal funds rate hikes but inflationary still remains above their 2% long-term target for Core PCE.

Retail Sales

Advance Retail Sales surprised to the upside in January, jumping 3.0% month-over-month versus -1.1% in the previous month and beating consensus expectations calling for a 2.0% increase. Retail sales rose 6.4% on a year-over-year basis. Vehicle sales, furniture and restaurants led the broad-based rebound. The Conference Board's Consumer Confidence Index decreased more than expected to 107.1 in January from an upwardly revised 109 in December. Although views of current conditions and the future outlook for the economy both improved, fewer consumers plan to buy a home and inflation expectations increased slightly to 6.8%.

Labor Market

The U.S. economy added a whopping 517,000 jobs in January, far surpassing market expectations of 189,000 jobs and December's upwardly revised 260,000 jobs. Trends in employment remain strong, with the three-month moving average payrolls at 356,000 and the six-month moving average at 349,000. Job growth was widespread, led by roles in the private sector with leisure and hospitality employment growth remaining solid. The unemployment rate dipped to 3.4%, below its pre-pandemic level. The labor participation rate increased slightly to 62.4% in January from 62.3% in December, indicating the supply of labor remains challenging for employers. The U-6 underemployment rate, which includes those who are marginally attached to the labor force and employed part time for economic reasons increased to 6.6% from the prior month at 6.5%. Average hourly earnings rose 4.4% year-over-year in January, down from an upwardly revised 4.8% increase in December. Job Openings increased to 11 million with the openings rate increasing in establishments with 50-249 employees but decreasing in establishments with more than 5,000 employees. Overall, the January employment report demonstrates a strong demand for labor and supports the case for the Fed to continue raising the federal funds rate at a slower pace.

Housing Starts

Total housing starts fell 1.4% month-over-month in December to 1,382,000 units and were down 21.8% compared to December 2021. The dip was entirely due to a 19% decline in starts of multi-unit homes but was somewhat offset by an increase in starts of single-family homes as mortgage rates eased. The 30-year fixed rate mortgage has dropped to an average of 5.95% according to Freddie Mac, down from a peak of over 7% in November. According to the Case-Shiller 20-City Home Price Index, the year-over-year increase continued its declining rate of gain to +6.8% in November from +8.6% in October, clearly displaying the impact of higher mortgage rates year-over-year, which have reduced demand for homebuying as affordability has declined. This is the fifth consecutive month of declining home prices in the US.

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.

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