BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

CHANDLER ASSET MANAGEMENT

JANUARY 2022

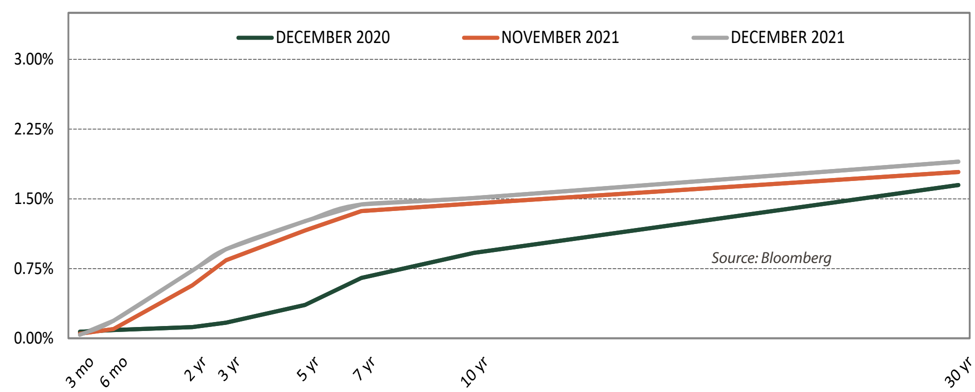
Market Summary

Fed policymakers have recently pivoted toward a more hawkish stance as inflation indices continue to run hot and the labor market appears relatively tight, given their dual mandate of promoting maximum employment and stable prices. Although labor force participation remains lower than it was prior to the pandemic, there are signals the economy may be near full employment within the context of the current health situation. The unemployment rate declined from 6.7% to 3.9% in 2021, a high percentage of workers are voluntarily quitting jobs, the level of job openings relative to those looking for work remains high, and wage growth has been strong. Meanwhile, inflation continues to run well above the Fed's long-run 2.0% target. The Consumer Price Index excluding food and energy was up 5.5% in December. The Core PCE index, the Fed's preferred inflation measure, was up 4.7% year-over-year in the latest report. Given the current inflation and employment dynamics, Fed policymakers have begun discussing plans to remove monetary policy accommodation. The Fed is currently tapering its asset purchases and we expect that process will be complete within the next few months. Should aggregate demand remain strong and economic activity remain robust, we believe the first rate hike may be announced in the first half of this year after the taper is complete. However, we do not believe monetary policy is on a pre-set course. We expect the Fed to adjust policy at a gradual pace and believe policymakers will adjust their views as necessary based on incoming economic and financial market data.

We believe US economic growth is likely to moderate this year but remain above the long-run trend rate of growth. The consensus forecast for GDP growth this year is 3.9% versus estimated growth of 5.6% in 2021. Amid the current surge of virus infection rates, we believe global supply chains remain challenged and we see risk to the first quarter US GDP consensus estimate of 3.9%. Nevertheless, we believe aggregate consumer demand remains strong and consumer spending, the largest component of US GDP, should remain solid this year, supported by healthy consumer balance sheets, an improving health situation, and ongoing improvement in the labor market. We expect supply chain bottlenecks will continue to put upward pressure on inflation over the near-term but we believe inflation may be at or near a peak, We believe pricing pressure is likely to abate in the second half of this year amid an improving global health backdrop and less acute global supply chain stress.

In December, the 2-year Treasury yield increased nearly 17 basis points to 0.73%, the 5-year Treasury yield increased ten basis points to 1.26%, and the 10-year Treasury yield increased about seven basis points to 1.51% in the month. We have witnessed a relatively swift move in Treasury rates this month with the 2-year Treasury yield up roughly 19 basis points, and the 10-year Treasury yield up more than 20 basis points, year-to-date.

TREASURY YIELDS ARE LIKELY POISED TO INCREASE



At the end of December, the 2-year Treasury yield was about 61 basis points higher and the 10-Year Treasury yield was about 60 basis points higher, year-over-year. We believe Treasury yields are likely to increase further this year, across the curve.

TREASURY YIELDS	Trend (▲/▼)	12/31/2021	11/30/2021	Change
3-Month	▼	0.04	0.05	(0.01)
2-Year	▲	0.73	0.57	0.17
3-Year	▲	0.96	0.84	0.12
5-Year	▲	1.26	1.16	0.10
7-Year	▲	1.44	1.37	0.06
10-Year	▲	1.51	1.45	0.06
30-Year	▲	1.90	1.79	0.11

Source: Bloomberg

Market Data

World Stock Market Indices
data as of 12/31/2021

	Change (11/30/21)	%CHG
S&P 500		
4,766.18	199.18	4.36%
NASDAQ		
15,644.97	107.28	0.69%
DOW JONES		
36,338.30	1,854.58	5.38%
FTSE (UK)		
7,384.54	325.09	4.61%
DAX (Germany)		
15,884.86	784.73	5.20%
Hang Seng (Hong Kong)		
23,397.67	-77.59	-0.33%
Nikkei (Japan)		
28,791.71	969.95	3.49%

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 December

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top rated commercial paper	0.07	0.08	(0.01)
2-year A corporate note	0.16	0.23	(0.07)
5-year A corporate note	0.40	0.45	(0.05)
5-year Agency note	0.02	0.06	(0.04)

Source: Bloomberg Data as of 12/31/2021

Supply and Demand Imbalances Continue to Impact Economic Data

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(80.17) $Bln NOV 21	(67.16) $Bln OCT 21	(67.31) $Bln NOV 20
Gross Domestic Product	2.30% SEP 21	6.70% JUN 21	33.80% SEP 20
Unemployment Rate	3.90% DEC 21	4.20% NOV 21	6.70% DEC 20
Prime Rate	3.25% DEC 21	3.25% NOV 21	3.25% DEC 20
Commodity Research Bureau Index	232.37 DEC 21	219.19 NOV 21	167.80 DEC 20
Oil (West Texas Int.)	$76.99 DEC 21	$66.18 NOV 21	$48.52 DEC 20
Consumer Price Index (y/o/y)	7.00% DEC 21	6.80% NOV 21	1.40% DEC 20
Producer Price Index (y/o/y)	13.30% NOV 21	12.60% OCT 21	(1.30%) NOV 20
Euro/Dollar	1.14 DEC 21	1.13 NOV 21	1.22 DEC 20

Source: Bloomberg

Economic Roundup

Consumer Prices

The Consumer Price Index (CPI) was up 7.0% year-over-year in December, versus up 6.8% year-over-year in November. Core CPI (CPI less food and energy) was up 5.5% year-over-year in December, versus up 4.9% in November. The Personal Consumption Expenditures (PCE) index was up 5.7% year-over-year in November, up from 5.1% in October. Core PCE was up 4.7% year-over-year in November, versus up 4.2% in October. Current inflation readings continue to run well above the Fed's longer-run target of around 2.0%. Upward pressure on inflation from supply chain bottlenecks and pandemic-related disruptions is likely to remain elevated over the near-term.

Retail Sales

On a year-over-year basis, retail sales were up 18.2% in November versus up 16.3% in October. On a month-over-month basis, retail sales were softer than expected in November, up 0.3% versus expectations of 0.8%, but this followed an upwardly revised gain of 1.8% in October. In our view, the data suggests that consumers may have started shopping early this holiday season in anticipation of supply shortages. Higher gas prices seem to have taken some wallet share, with spending at gasoline stations up 1.7% month-over-month. Amid the current resurgence of virus cases, the near-term outlook for retail sales is uncertain, and nonstore retailers (online) may be poised to outperform.

Labor Market

Job growth slowed in December, with US nonfarm payroll growth of just 199,000 in the month versus the consensus forecast of 450,000, but the unemployment rate still declined to 3.9%, the lowest level since February 2020. On a trailing 3-month and 6-month basis, payrolls increased an average of 365,000 and 508,000 per month, respectively, which still compares favorably to the average job gains in the five years leading up to the pandemic of about 196,000 per month. We believe a variety of factors are keeping some workers out of the labor force for now, which continues to hold back job growth despite strong demand from employers. The labor participation rate was unchanged in December at 61.9% and remains lower than the pre-pandemic level of 63.4%. The employment-population ratio increased to 59.5% in December form 59.3% in November, but also remains below the pre-pandemic level of 61.2%. The U-6 underemployment rate, which includes those who are marginally attached to the labor force and employed part time for economic reasons, declined to 7.3% in December from 7.7% in November (versus 7.0% in February 2020). Annualized average hourly earnings rose 0.6% month-over-month and were up 4.7% year-over-year in December versus 5.1% in November.

Housing Starts

Total housing starts jumped 11.8% in November to an annual pace of 1,679,000. Single-family starts increased 11.3% while multi-family starts increased 12.9%, month-over-month. On a year-over-year basis total housing starts were up 8.3% in November.

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.