# BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

CHANDLER ASSET MANAGEMENT

JANUARY 2023

## Market Data

*World Stock Market Indices*
*data as of 12/31/2022*

| | Change (11/30/2022) | %CHG |
|---|---|---|
| **S&P 500** | | |
| **3,839.50** | -240.61 | -5.90% |
| **NASDAQ** | | |
| **10,466.48** | -1,001.52 | -8.73% |
| **DOW JONES** | | |
| **33,147.25** | -1,442.52 | -4.17% |
| **FTSE (UK)** | | |
| **7,451.74** | -121.31 | -1.60% |
| **DAX (Germany)** | | |
| **13,923.59** | -473.45 | -3.29% |
| **Hang Seng (Hong Kong)** | | |
| **19,781.41** | 1,184.18 | 6.37% |
| **Nikkei (Japan)** | | |
| **26,094.50** | -1,874.49 | -6.70% |

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

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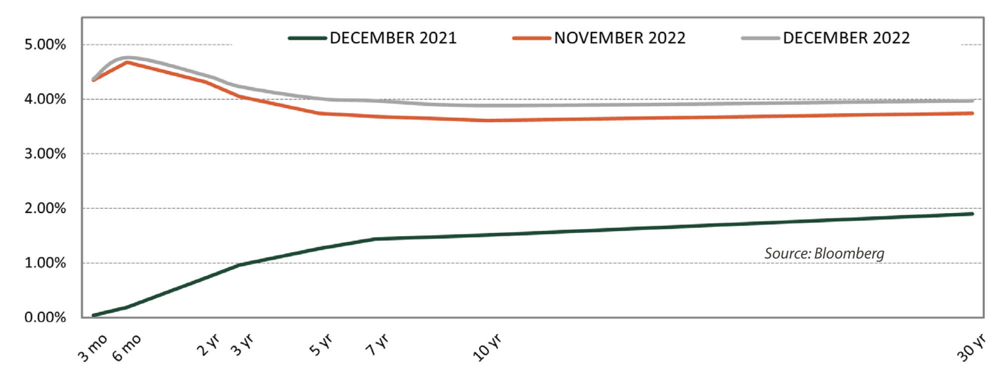
## Market Summary

Market volatility has intensified as global central banks pursue monetary policies to combat persistently high inflation. Although the pace of job growth is moderating, the strength of the labor market has sustained economic growth. Inflation metrics are trending downward but remain significantly higher than the Fed's target. While evidence of slower economic conditions has begun to mount, we expect the Federal Reserve to continue to raise rates to battle inflation, albeit at a less aggressive pace. Over the near-term, we expect financial market volatility to remain intensified with persistent inflation, geopolitical risk, and the Fed's hawkish monetary policy.

As expected at the December 14th meeting, the Federal Open Market Committee (FOMC) raised the fed funds target rate by 50 basis points to a range of 4.25 – 4.50%, in a downshift from four consecutive 75 basis point hikes. The decision was unanimous, and there was no change to the November statement. The sentiment was hawkish, indicating that "ongoing increases" in the fed funds rate are likely appropriate and citing continued labor market imbalances. FOMC members forecasted a higher fed funds rate, slower GDP growth, higher inflation, and higher unemployment in 2023 than in the September projections. 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.

In December, yields rose, and the curve became less inverted. The 2-year Treasury yield increased 12 basis points to 4.43%, the 5-year Treasury yield rose 27 basis points to 4.01%, and the 10-year Treasury yield climbed 27 basis points to 3.88%. The inversion between the 2-year Treasury yield and 10-year Treasury yield narrowed to -55 basis points at December month-end versus -71 basis points at November month-end. The spread was a positive 78 basis points one year ago. The inversion between 3-month and 10-year treasuries narrowed to -50 basis points in December from -74 basis points in November. 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. The shape of the yield curve indicates that the probability of recession is increasing.

### Treasury Yields Increased in December




Yields on Treasury securities increased in December and remain significantly higher from a year ago. The 2-year Treasury yield was 369 basis points higher, and the 10-Year Treasury yield was about 236 basis points higher, year-over-year. The inversion between 3-month and 10-year Treasury yields narrowed to -50 basis points in December from -74 basis points in November. The average historical spread between the 2-year Treasury and 10-Year Treasury yield (since 2003) is about +125 basis points. Inverted yield curves are typically harbingers of slower economic growth or an increased probability of a recession in the future.

| TREASURY YIELDS | Trend (▲/▼) | 12/30/2022 | 11/30/2022 | Change |
|---|---|---|---|---|
| 3-Month | ▲ | 4.37 | 4.35 | 0.02 |
| 2-Year | ▲ | 4.43 | 4.31 | 0.12 |
| 3-Year | ▲ | 4.23 | 4.05 | 0.18 |
| 5-Year | ▲ | 4.01 | 3.74 | 0.27 |
| 7-Year | ▲ | 3.97 | 3.68 | 0.29 |
| 10-Year | ▲ | 3.88 | 3.61 | 0.27 |
| 30-Year | ▲ | 3.97 | 3.74 | 0.23 |

*Source: Bloomberg*

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 | 0.25 | 0.22 | 0.03 |
| 2-year A corporate note | 0.45 | 0.37 | 0.07 |
| 5-year A corporate note | 0.84 | 0.92 | (0.09) |
| 5-year Agency note | 0.13 | 0.29 | (0.15) |

*Source: Bloomberg*

Data as of 12/30/2022

**Inflation Remains above the Federal Reserve's Target but has Receded from its Recent Highs**

| ECONOMIC INDICATOR | Current Release | Prior Release | One Year Ago |
|---|---|---|---|
| Trade Balance | (61.51) $Bln NOV 22 | (77.85) $Bln OCT 22 | (77.98) $Bln NOV 21 |
| Gross Domestic Product | 3.20% SEP 22 | (0.60%) JUN 22 | 2.70% SEP 21 |
| Unemployment Rate | 3.50% DEC 22 | 3.60% NOV 22 | 3.90% DEC 21 |
| Prime Rate | 7.50% DEC 22 | 7.00% NOV 22 | 3.25% DEC 21 |
| Refinitiv/CoreCommodity CRB Index | 277.75 DEC 22 | 279.76 NOV 22 | 232.37 DEC 21 |
| Oil (West Texas Int.) | $80.26 DEC 22 | $80.55 NOV 22 | $76.56 DEC 21 |
| Consumer Price Index (y/o/y) | 6.50% DEC 22 | 7.10% NOV 22 | 7.00% DEC 21 |
| Producer Price Index (y/o/y) | 10.60% NOV 22 | 11.20% OCT 22 | 13.30% NOV 21 |
| Euro/Dollar | 1.07 DEC 22 | 1.04 NOV 22 | 1.14 DEC 21 |

*Source: Bloomberg*

## Economic Roundup

**Consumer Prices**

The Consumer Price Index (CPI) decreased to up 6.5% on a year-over-year in December versus up 7.1% in November, in line with consensus expectations. The Core CPI, which excludes volatile food and energy components, declined to up 5.7% year-over-year, down from up 6.0% increase in November. Food and shelter costs continued to rise but were offset by broad price declines in energy. The Personal Consumption Expenditures (PCE) index rose 5.5% year-over-year in November, versus an upwardly revised 6.1% year-over-year gain in October. Core PCE increased 4.7% year-over-year in November versus a 5.0% year-over-year gain in October. Although inflation may have peaked, levels remain well above the Fed's target of around 2%, which is likely to keep the Federal Reserve on the path of tightening monetary policy, albeit at a less aggressive pace.

**Retail Sales**

Advance Retail Sales declined more than expected in November at -0.6% month-over-month and +6.5% year-over-year, possibly suggesting some loss of momentum in consumer demand for goods amid high inflation and shifting preferences toward services. Additionally, Amazon's Prime Day may have pulled some holiday spending activity forward into October from November. The Conference Board's Consumer Confidence Index jumped more than expected to 108.3 in December from an upwardly revised 101.4 in November. Views of current conditions and the future outlook for the economy both improved as inflation expectations declined.

**Labor Market**

The U.S. economy added 223,000 jobs in December, slightly higher than market expectations of 205,000, but a decline from November's revised increase of 256,000. Trends in employment remain healthy, with the three-month moving average payrolls at 247,000 and the six-month moving average at 307,000. Jobs in the goods producing sector were surprisingly strong, and leisure and hospitality employment growth remained solid. The unemployment rate dipped to 3.5%, returning to its pre-pandemic level. The labor participation rate increased only slightly to 62.3% in December from 62.1% in November, 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 declined to 6.5% from the prior month at 6.7%. Average hourly earnings rose 4.6% year-over-year in December, down from a revised 4.8% increase in November. Overall, the December employment report demonstrates a strong demand for labor and supports the case for the Fed to continue raising the federal funds rate, but perhaps at a slower pace.

**Housing Starts**

Total housing starts declined 0.5% in November to 1,427,000 units after an upward revision to 1,434,000 units in October. Single-family home starts fell 4.1%, whereas multi-family starts rose 4.9% month-over-month. On a year-over-year basis, total housing starts decreased 16.4% reflecting a shift from single-family units to more affordable multi-family units as homebuyers struggle with a combination of elevated prices and higher mortgage rates. The 30-year mortgage rate has edged up to 6.4% according to Freddie Mac but remains below recent highs which topped 7%. According to the Case-Shiller 20-City Home Price Index, the year-over-year increase continued its declining rate of gain to +8.6% in October from +10.4% in September, clearly displaying the impact of higher mortgage rates which have reduced demand for homebuying as affordability has declined.

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.