CHANDLER ASSET MANAGEMENT

# BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

SEPTEMBER 2023

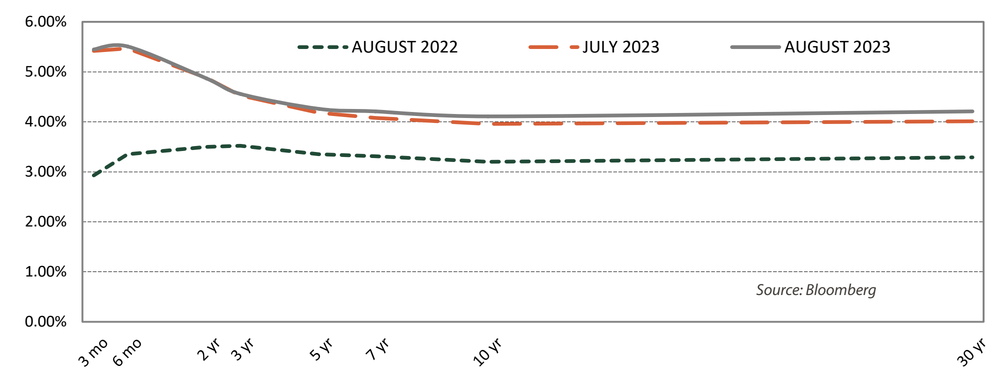
## Market Summary

Recent economic data continues to suggest positive but below trend growth this year. Although the pace of job growth is moderating, labor markets remain solid, and the U.S. consumer has demonstrated resiliency. Inflationary trends are subsiding, but core levels remain well above the Fed's target. Given the cumulative effects of restrictive monetary policy and tighter financial conditions, we believe the economy will gradually soften and the Fed will remain data dependent as they tread cautiously going forward.

As anticipated at the July meeting, the Federal Open Market Committee voted unanimously to raise the Federal Funds rate by 0.25% to a target range of 5.25 - 5.50%, the highest level in over 20 years. Fed Chair Powell maintained that the FOMC will remain data dependent going forward, and that they do not anticipate a recession, leaving the option open for the possibility of additional rate hikes in the future if needed.

Bond yields experienced upward pressure in August as investors sought higher returns, partly due to the U.S. Treasury's issuance of $103 billion in their quarterly refunding. During the month, the 2-year Treasury yield remained relatively stable, ending at 4.87%, while the 5-year Treasury yield increased by 8 basis points to 4.26%. Additionally, the 10-year Treasury yield saw a notable uptick of 15 basis points, reaching 4.11%. These fluctuations in yields reflect the evolving dynamics in the bond market, influenced by various economic and financial factors. It is worth noting that the yield curve has remained inverted since July 2022, signaling potential economic concerns or uncertainties.

**Treasury Yields Increased Across the Curve in August**




Interest rates increased across the yield curve in August in response to Federal Reserve Chair Jerome Powell's commitment to maintaining the 2% inflation target. Moreover, the U.S. Treasury issued an additional supply of $103 billion during the month as part of its regularly scheduled quarterly refunding. Despite these developments, the Treasury yield curve remained inverted, although there was a narrowing of the inversion between the 2-year and 10-year Treasury yields, narrowing from -92 basis points at the close of July to -76 basis points by the end of August. Notably, one year prior, the difference between the 2-year and 10-year Treasury yields stood at -30 basis points. Furthermore, the inversion between the 3-month and 10-year Treasuries also contracted, decreasing to -134 basis points from July to August. The current inversion of the yield curve has been persistent since July 1, 2022, indicating ongoing economic uncertainties.

| TREASURY YIELDS | Trend (▲/▼) | 08/31/2023 | 07/31/2023 | Change |
|---|---|---|---|---|
| 3-Month | ▲ | 5.45 | 5.42 | 0.03 |
| 2-Year | ▼ | 4.87 | 4.88 | -0.01 |
| 3-Year | ▲ | 4.56 | 4.53 | 0.03 |
| 5-Year | ▲ | 4.26 | 4.18 | 0.08 |
| 7-Year | ▲ | 4.21 | 4.08 | 0.13 |
| 10-Year | ▲ | 4.11 | 3.96 | 0.15 |
| 30-Year | ▲ | 4.21 | 4.01 | 0.20 |

*Source: Bloomberg*

## Market Data

*World Stock Market Indices*
*data as of 08/31/2023*

| | | Change (07/31/2023) | %CHG |
|---|---|---|---|
| S&P 500 | **4,507.66** | (81.30) | (1.77%) |
| NASDAQ | **14,034.97** | (311.05) | (2.17%) |
| DOW JONES | **34,721.91** | (837.62) | (2.36%) |
| FTSE (UK) | **7,439.13** | (260.28) | (3.38%) |
| DAX (Germany) | **15,947.08** | (499.75) | (3.04%) |
| Hang Seng (Hong Kong) | **18,382.06** | (1,696.88) | (8.45%) |
| Nikkei (Japan) | **32,619.34** | (552.88) | (1.67%) |

*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 were Little Changed in August**

| CREDIT SPREADS | Spread to Treasuries (%) | One Month Ago (%) | Change |
|---|---|---|---|
| 3-month top rated commercial paper | 0.05 | 0.08 | (0.03) |
| 2-year A corporate note | 0.41 | 0.28 | 0.13 |
| 5-year A corporate note | 0.72 | 0.65 | 0.07 |
| 5-year Agency note | 0.09 | 0.09 | (0.00) |

*Source: Bloomberg*

Data as of 08/31/2023

**General Inflationary Trends Remain Constructive**

| ECONOMIC INDICATOR | Current Release | Prior Release | One Year Ago |
|---|---|---|---|
| Trade Balance | (65.02) $Bln JUL 23 | (63.72) $Bln JUN 23 | (71.67) $Bln JUL 22 |
| Gross Domestic Product | 2.10% JUN 23 | 2.00% MAR 23 | (0.60%) JUN 22 |
| Unemployment Rate | 3.80% AUG 23 | 3.50% JUL 23 | 3.70% AUG 22 |
| Prime Rate | 8.50% AUG 23 | 8.50% JUL 23 | 5.50% AUG 22 |
| Refinitiv/CoreCommodity CRB Index | 281.91 AUG 23 | 282.18 JUL 23 | 290.41 AUG 22 |
| Oil (West Texas Int.) | $83.63 AUG 23 | $81.80 JUL 23 | $89.55 AUG 22 |
| Consumer Price Index (y/o/y) | 3.70% AUG 23 | 3.20% JUL 23 | 8.30% AUG 22 |
| Producer Price Index (y/o/y) | (2.20%) AUG 23 | (1.00%) JUL 23 | 12.80% AUG 22 |
| Euro/Dollar | 1.08 AUG 23 | 1.10 JUL 23 | 1.01 AUG 22 |

*Source: Bloomberg*

## Economic Roundup

**Consumer Prices**

Inflation data continues to provide encouraging indications of moderating inflation trends. The Consumer Price Index (CPI) witnessed a monthly increase of 0.6% in August, while the annual rate of the CPI rose to 3.7% due to an unfavorable year-over-year comparison. The core Consumer Price Index, excluding volatile food and energy costs, showed a modest 0.3% rise, reaching a year-over-year rate of 4.3%, down from 4.7% in July. The Personal Consumption Expenditures (PCE) index rose as expected by 3.3% year-over-year in July, up from a 3.0% year-over-year gain in June. Core PCE, the Federal Reserve's preferred inflation gauge, increased by 4.2% year-over-year in July, up from a 4.1% increase in June. Personal spending remained robust, but the personal savings rate decreased to 3.5% from 4.3% in July. Inflation remains above the Fed's 2% target.

**Retail Sales**

Advance Retail Sales beat expectations and rose 0.7% in July after upward revisions to the prior two months. Increases were broad-based across categories. Nonstore retail sales were particularly notable with a 1.9% increase, which reflects a robust performance of Amazon's Prime Day sales event. On a year-over-year basis, retail sales growth accelerated to a 3.2% gain in July versus an upwardly revised 1.6% increase in June. The Conference Board's Consumer Confidence Index dropped more than expected to 106.1 in August from a downwardly revised 114.0 in July. Both current conditions and future expectations weakened as respondents expressed negative views on the labor market and concerns regarding inflation expectations.

**Labor Market**

The U.S. economy added 187,000 jobs in August, exceeding consensus expectations, and the last two months were revised downward by 110,000 jobs. The pace of job growth is softening with the three-month moving average payrolls at 150,000 and the six-month moving average at 194,000. The unemployment rate rose to 3.8% in August from 3.5% in July, and the labor force participation rate increased to 62.8%, the highest level since February of 2020. 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 7.1% from the prior month at 6.7%. Average hourly earnings declined to 4.3% year-over-year in August from 4.4% in July. While the U.S. labor market is moderating, employment remains strong by historical standards.

**Housing Starts**

Starts of new homes increased 3.9% to 1.452 million units at a seasonally adjusted annual rate in July after a downward revision to 1.398 million units in June. The gain was entirely attributable to a rise of 6.7% in single-family home starts. Starts of multi-unit homes had been the main driver of homebuilding in the second half of 2022 and early 2023 but have begun to wane. Total starts of new homes are up 5.9% year-over-year. Homebuilders continue to see demand while the supply of existing homes for sale remains limited. According to Freddie Mac, a 30-year fixed rate mortgage averaged 7.18% as of August 31st. According to the Case-Shiller 20-City Home Price Index, housing prices dropped 1.2% year-over-year in June, improving from a 1.7% decline in May. Tight inventories and higher mortgage rates continue to impact affordability.

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.