

# Monthly Market Review

Fixed Income | September 2022

Information provided by Illinois Trust's Investment Adviser PFM Asset Management LLC



**"It's a bird! It's a plane! It's...interest rates"**

## Economic Highlights

▶ Federal Reserve (Fed) officials doubled down on their inflation-fighting mantra, highlighted by Fed Chair Jerome Powell's comments at the annual economic symposium in Jackson Hole, WY. Powell said the Fed's "overarching focus right now is to bring inflation back down," adding "restoring price stability will take some time and requires using our tools forcefully."

▶ Powell also noted, "The labor market is particularly strong, but it is clearly out of balance, with demand for workers substantially exceeding the supply of available workers." This was confirmed by the recent employment report, which showed that the U.S. economy added 315,000 jobs in August, modestly exceeding expectations. The unemployment rate rose to 3.7% from 3.5%, driven by improvements in the labor force participation. Average hourly earnings, an important measure of wages, grew by a solid 5.2% over the past year but continued to lag surging inflation. Weekly unemployment claims have also fallen for five straight weeks.

▶ Inflation remained sticky, with the overall consumer price index (CPI) rising 8.3% over the past year (down from 8.5% last month), while core CPI increased to 6.3% year-over-year (YoY). The report showed gasoline and energy prices fell sharply, but rents rose the most since 1991 and food has continued to rise at roughly 1% per month.

▶ First-time home buyers continue to face tough conditions as home prices and borrowing rates remain historically elevated. Building activity continued to slow while pending home sales plunged by more than 20% from a year ago.

▶ The final August results from the University of Michigan Survey of Consumers showed consumer sentiment improved from the prior month, perhaps reflecting the strong jobs market and falling gasoline prices.

▶ The Bloomberg recession probability index, which measures the chance of a recession in the U.S. over the next year, has risen to 50%. Growth in Europe is an even more serious emerging concern, considering the impact of elevated European natural gas prices headed into winter.

## Bond Markets

▶ The Fed's consistently hawkish tone pushed U.S. Treasury yields sharply higher in August, setting the stage for another 75 basis point (0.75%) (bps) rate hike at the Fed's September meeting and pushing back against the possibility of eventual rate cuts next year. By mid-September, expectations for Fed funds pointed to a terminal rate of nearly 4.5% by March 2023.

▶ The benchmark 6-month, 2-year, and 10-year Treasury yields finished August at 3.33%, 3.49%, and 3.19%, up 49, 61, and 54 bps (0.49%, 0.61%, and 0.54%), respectively.

▶ Fixed income U.S. Treasury index total returns were mostly negative in August. The ICE BofA 6-month, 2-year, and 10-year Treasury indices returned 0.15%, -0.78%, and -1.90%, respectively, for the month.

## Equity Markets

▶ What began as a strong month for the three major averages ended on a decidedly weaker note, cementing the weakest August performance in seven years as worries about aggressive interest rate hikes from the Fed hurt valuations. The S&P 500 finished August down 4.1%, while the Dow and Nasdaq posted monthly losses of 3.7% and 4.5%, respectively.

▶ The U.S. dollar continued its trend higher as the U.S. Dollar Index (DXY) advanced 3.0% in August to a new 20-year high.

## PFMAM Strategy Recap

▶ Given persistently elevated inflation and expectations for more Fed rate hikes, we plan to maintain our modest defensive duration bias relative to benchmarks. But, we recognize that 2-5 year Treasury yields at 14-15 year highs offer solid income potential and are beginning to shift the risk/reward dynamic. Historically, yields tend to peak before the last rate hike of a cycle.

▶ While federal agency non-callable securities continue to offer limited value relative to U.S. Treasuries, callable agencies have become attractive, offering wider than normal yield spreads.

▶ Investment-grade (IG) corporate yield spreads vs. Treasuries narrowed in August and generated outperformance. While value in the sector remains, certain industries and maturities offer much better value than others, making issue selection more important. We continue to seek issuers that can benefit from higher rates, can weather a modest economic downturn, and are better insulated from input cost pressures.

▶ Asset-backed security (ABS) spreads also narrowed in August, but remained wide relative to similarly-rated corporate notes. Higher energy costs, increasing rents, and negative real wage growth are potential headwinds for the consumer sector, but collateral performance remains solid and within rating parameters.

▶ Mortgage-backed securities (MBS) remained under pressure and were one of the few investment grade fixed income sectors to post negative excess returns for the month. Given increased Fed balance sheet reductions beginning in September, we remain defensive in the sector.

▶ Rates on short-term commercial paper, bank CDs and agency discount notes surged in lock-step with the Fed's expected rate hikes. Short-term investments now offer excellent income opportunities.

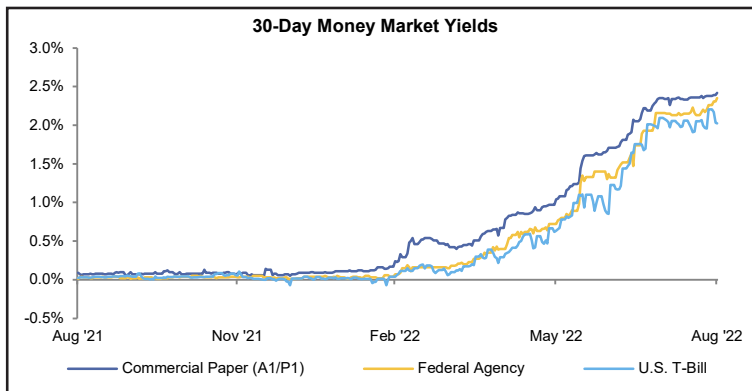
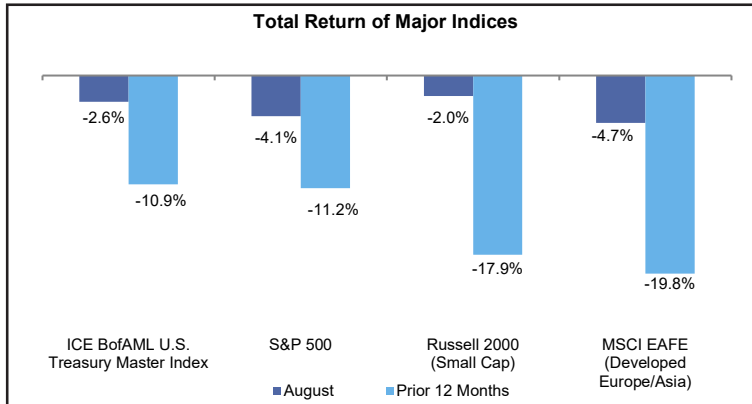
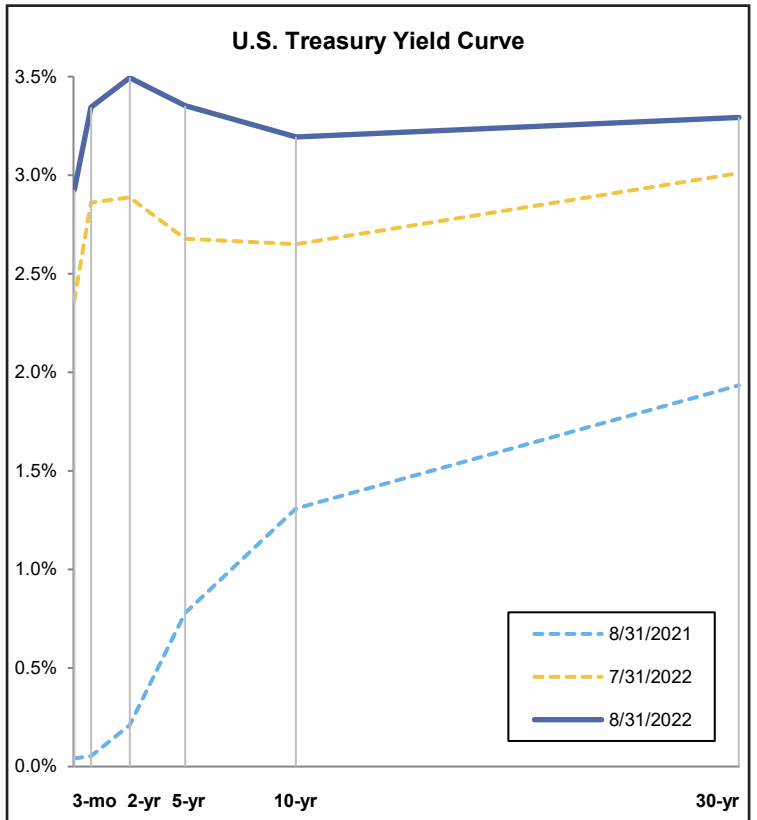
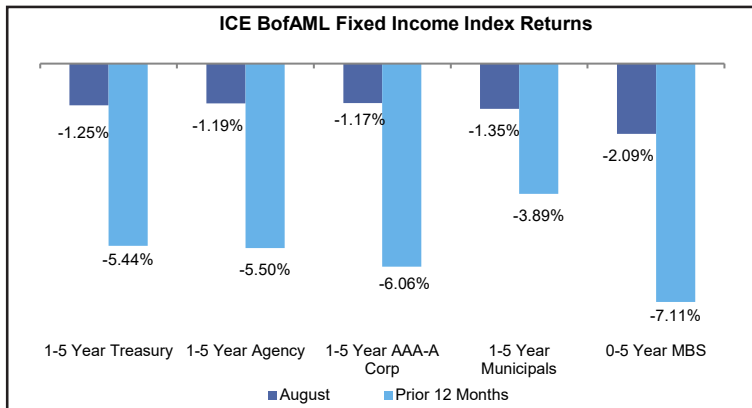
*This information is for institutional investor use only, not for further distribution to retail investors, and does not represent an offer to sell or a solicitation of an offer to buy or sell any fund or other security. Investors should consider the Trust's investment objectives, risks, charges and expenses before investing in the Trust. This and other information about the Trust is available in the Trust's current Information Statement, which should be read carefully before investing. A copy of the Trust's Information Statement may be obtained by calling 1-800-731-6870 for the IIIIT Class and 1-800-731-6830 for the IPDLAF+ Class and is also available on the Trust's websites at [www.iiit.us](http://www.iiit.us) and [www.ipdlaf.org](http://www.ipdlaf.org). While both the IIIIT and IPDLAF+ Classes of the Illinois Portfolio seek to maintain a stable net asset value of \$1.00 per share and the Illinois TERM series seek to achieve a net asset value of \$1.00 per share at its stated maturity, it is possible to lose money investing in the Trust. An investment in the Trust is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Shares of the Trust are distributed by PFM Fund Distributors, Inc., member Financial Industry Regulatory Authority (FINRA) ([www.finra.org](http://www.finra.org)) and Securities Investor Protection Corporation (SIPC) ([www.sipc.org](http://www.sipc.org)). PFM Fund Distributors, Inc. is an affiliate of PFM Asset Management LLC.*

U.S. Treasury Yields				
Duration	Aug 31, 2021	Jul 31, 2022	Aug 31, 2022	Monthly Change
3-Month	0.04%	2.36%	2.93%	0.57%
6-Month	0.05%	2.86%	3.35%	0.49%
2-Year	0.21%	2.89%	3.50%	0.61%
5-Year	0.78%	2.68%	3.35%	0.67%
10-Year	1.31%	2.65%	3.20%	0.55%
30-Year	1.93%	3.01%	3.29%	0.28%

Yields by Sector and Maturity				
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	2.93%	2.92%	3.28%	--
6-Month	3.35%	3.27%	3.37%	--
2-Year	3.50%	3.54%	3.76%	2.22%
5-Year	3.35%	3.45%	3.98%	2.32%
10-Year	3.20%	3.52%	4.26%	2.80%
30-Year	3.29%	3.91%	4.69%	3.40%

Spot Prices and Benchmark Rates				
Index	Aug 31, 2021	Jul 31, 2022	Aug 31, 2022	Monthly Change
1-Month LIBOR	0.08%	2.36%	2.55%	0.19%
3-Month LIBOR	0.12%	2.79%	3.10%	0.31%
Effective Fed Funds Rate	0.06%	2.32%	2.33%	0.01%
Fed Funds Target Rate	0.25%	2.50%	2.50%	0.00%
Gold (\$/oz)	\$1,816	\$1,763	\$1,717	-\$46
Crude Oil (\$/Barrel)	\$68.50	\$98.62	\$89.55	-\$9.07
U.S. Dollars per Euro	\$1.18	\$1.02	\$1.01	-\$0.01

Key Economic Indicators				
Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales Advance MoM	17-Aug	Jul	0.0%	0.1%
GDP Annualized QoQ	25-Aug	2Q S	-0.6%	-0.7%
PCE Core Deflator YoY	26-Aug	Jul	4.6%	4.7%
U. of Mich. Consumer Sentiment	26-Aug	Aug	58.2	55.5
ISM Manufacturing	1-Sep	Aug	52.8	51.9
Change in Non-farm Payrolls	2-Sep	Aug	315k	298k
Unemployment Rate	2-Sep	Aug	3.7%	3.5%



Source: Bloomberg. Data as of August 31, 2022, unless otherwise noted. The views expressed constitute the perspective of PFM Asset Management LLC at the time of distribution and are subject to change. The content is based on sources generally believed to be reliable and available to the public; however, PFMAM cannot guarantee its accuracy, completeness or suitability. This material is for general information purposes only and is not intended to provide specific advice or a specific recommendation.

PFM Asset Management LLC ("PFMAM") is an investment adviser registered with the U.S. Securities and Exchange Commission and a subsidiary of U.S. Bancorp Asset Management, Inc. ("USBAM"). USBAM is a subsidiary of U.S. Bank National Association ("U.S. Bank"). U.S. Bank is a separate entity and subsidiary of U.S. Bancorp. U.S. Bank is not responsible for and does not guarantee the products, services or performance of PFMAM.

**NOT FDIC INSURED : NO BANK GUARANTEE : MAY LOSE VALUE**