Monthly Market Review

pfm

"Summer dreams ripped at the seams."

Economic Highlights

- As summer began, a resurgence of COVID-19 cases spread across parts of the U.S., threatening the economic recovery, summer's lure and the economic consequences of prolonged lockdowns. This prompted U.S. states to reopen — perhaps prematurely. Whether a continuation of the first wave or the emergence of a new wave, one thing is certain: COVID-19 remains a rising public health threat, and the U.S. is struggling in a riptide of uncertainty.
- In his semiannual monetary policy report to Congress in mid-June, Federal Reserve (Fed) chair Jerome Powell painted a guarded view of the economy, noting "the levels of output and employment remain far below their pre-pandemic levels, and significant uncertainty remains about the timing and strength of the recovery." Meanwhile, the Fed's balance sheet grew to a historic high of $7.1 trillion as the central bank added to its holdings of open market securities, and the Fed continued to expand its use of liquidity and credit market support programs.
- The U.S. economy is now in its first recession in more than a decade, with gross domestic product falling by an annualized 5% in the first quarter, ending the longest period of economic expansion on record. Chair Powell suggested that the second-quarter decline "is likely to be the most severe on record."
- Despite these elements, the U.S. labor market rebounded strongly in back-to-back months. June's non-farm payrolls rose by 4.8 million, while the unemployment rate fell to 11.1% — marked improvement, but the unemployment rate remains far above pre-COVID-19 levels.
- Retail sales rebounded nearly 18% in May after cratering 8% and 15% in March and April, respectively. Similarly, on modest reopenings of the economy throughout the country, consumer confidence recovered sharply from five-year lows in March.

Bond Markets

- The U.S. Treasury yield curve drifted marginally lower by just one or two basis points in the month. They remain at historically low levels with the 10-year benchmark ending the month at 0.66%.
- The U.S. Treasury continued to borrow at a record pace to fund the unprecedented series of stimulus packages by selling nearly a half-trillion of bills and bonds. The federal budget deficit in June alone was nearly equivalent to the deficit for the entire prior fiscal year.
- Given low and very stable rates, Treasury returns were muted in June, with intermediate-term maturities outperforming both their shorter and longer counterparts by only small margins. For June, the 3-month Treasury Bill returned 0.01%, while the 5-year and 10-year Treasury indexes returned 0.17% and -0.01%, respectively.
- Investment-grade (IG) corporate bonds generated strong excess returns as spreads tightened to near pre-crisis levels. IG companies issued $178 billion of debt in June as the Fed's backstop to purchase corporate notes became an opportunity for issuers to tap sources of liquidity. Market appetite for both new and secondary inventory remained strong, helping to pressure credit spreads to narrow.
- As most all non-U.S. Treasury sectors again benefited from a continued retracement of spreads from peak crisis levels in mid-March, sector diversification helped to buoy portfolio performance in June.

Equity Markets

- U.S. equities ventured forward on vaccine optimism and better-than-expected economic data. The Dow Jones Industrial Average finished its best quarter since 1987, surging 17.8%. For the month, the S&P 500 gained 1.8%; the Dow rose 1.7% and the NASDAQ jumped 6.0%.
- Global developed market equities rallied, while the ACWI ex-U.S. measure of development market equities grew 4.5%, reflecting in part the great progress that other developed nations have made in battling COVID-19. The U.S. Dollar Index (DXY) depreciated by 1.0%, while gold rose 2.9%.

PFM Outlook

- With little opportunity presented by the shape of the treasury yield curve and bond market volatility low, there is no compelling reason to move from a benchmark-neutral duration strategy. We will rebalance portfolios monthly to match index duration extensions.
- Value persists in the federal agency sector, with new issues offering attractive concessions to lure buyers. Callable agencies with longer lockouts have also become more attractive as the additional yield represents value with rates in a low, stable range.
- In the corporate sector, PFM took advantage of the flurry of new issuance to extend maturities, focusing on new purchases in the steep credit curve (greater than three years) and extending durations. Issuer preference was selective, as strong balance sheets and diversification are favored in this uncertain time.
- AAA-rated asset-backed securities also offered good value. Following periods of heightened volatility, PFM removed the hold status on the sector and became active buyers of new issues during the month. Due diligence on structure was critical in our decision to participate as stress tests indicated the ability to withstand adverse market pressures.
- Mortgage-backed securities offered a mixed bag as specific coupon and structure were key drivers of performance on the heels of prepayment variability. The sector appears to have found a level of normalization based on the Fed's commitment. PFM's investments are aimed at maintaining allocations in the sector as issues pay-down principal.
- Taxable municipal debt remains one of the more attractive alternatives in the current market. At relatively elevated spreads, these high-quality issues — particularly those that are taxable — have been purchased for many portfolios over the past several weeks. Although somewhat supply constrained, we will continue to participate broadly in attractively priced new issues.

U.S. Treasury Yields

Duration	Jun 30, 2019	May 31, 2020	Jun 30, 2020	Monthly Change
3-Month	2.09%	0.14%	0.14%	0.00%
6-Month	2.10%	0.16%	0.16%	0.00%
2-Year	1.76%	0.16%	0.15%	-0.01%
5-Year	1.77%	0.30%	0.29%	-0.01%
10-Year	2.01%	0.65%	0.66%	0.01%
30-Year	2.53%	1.41%	1.41%	0.00%

Yields by Sector and Maturity as of June 30, 2020

Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	0.14%	0.12%	0.32%	--
6-Month	0.16%	0.13%	0.36%	--
2-Year	0.15%	0.22%	0.44%	0.39%
5-Year	0.29%	0.46%	0.87%	0.68%
10-Year	0.66%	1.01%	1.72%	1.26%
30-Year	1.41%	1.63%	2.82%	1.88%

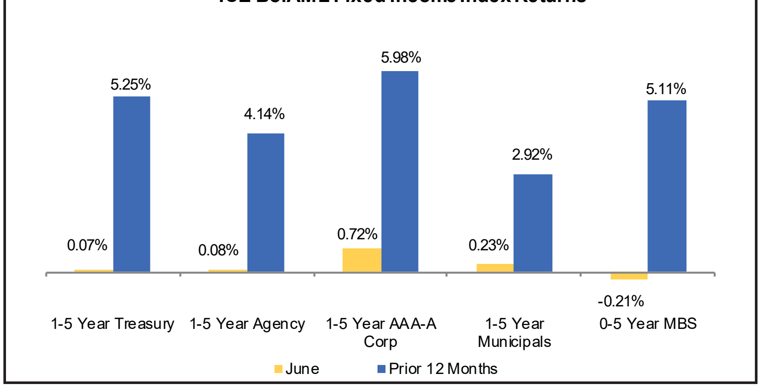
Spot Prices and Benchmark Rates

Index	Jun 30, 2019	May 31, 2020	Jun 30, 2020	Monthly Change
1-Month LIBOR	2.40%	0.18%	0.16%	-0.02%
3-Month LIBOR	2.32%	0.34%	0.30%	-0.04%
Effective Fed Funds Rate	2.40%	0.05%	0.08%	0.03%
Fed Funds Target Rate	2.50%	0.25%	0.25%	0.00%
Gold ($/oz)	$1,414	$1,737	$1,801	$64
Crude Oil ($/Barrel)	$58.47	$35.49	$39.27	$3.78
U.S. Dollars per Euro	$1.14	$1.11	$1.12	$0.01

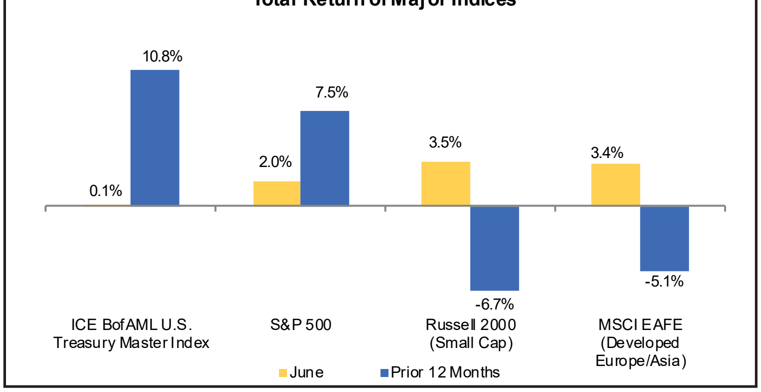
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Consumer Confidence	30-Jun	Jun	98.1	91.5
GDP Annualized QoQ	25-Jun	1Q T	-5.0%	-5.0%
PCE Core Deflator YoY	26-Jun	May	1.0%	0.9%
FOMC Rate Decision (Upper)	1-Jul	Jun	52.6	49.8
Non-farm Payrolls	2-Jul	Jun	11.1%	12.5%
Unemployment Rate	2-Jul	Jun 20	19,290k	19,000k
ISM Manufacturing	2-Jul	Jun	61.5%	61.2%

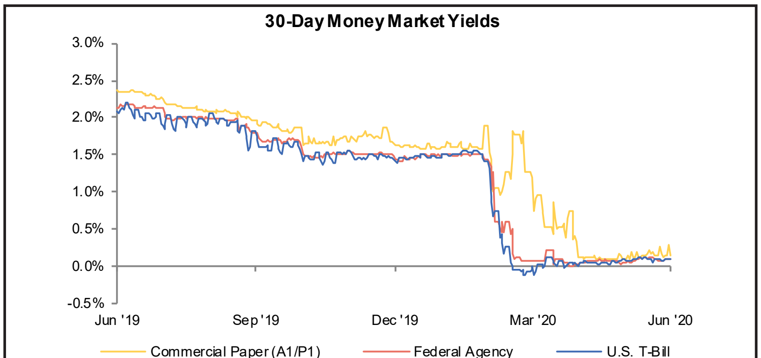
ICE BofAML Fixed Income Index Returns



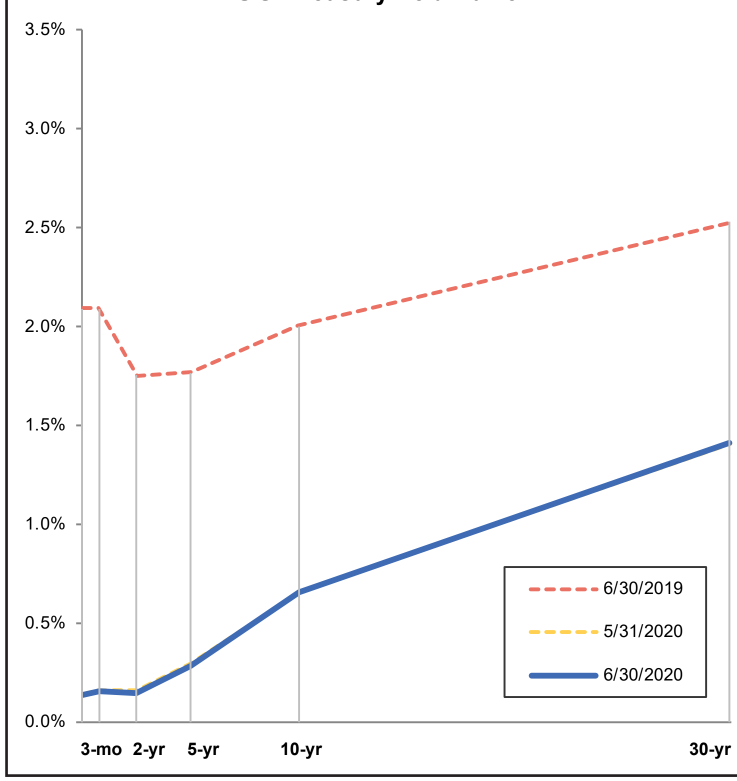
Total Return of Major Indices



30-Day Money Market Yields



U.S. Treasury Yield Curve



Source: Bloomberg. Data as of June 30, 2020, unless otherwise noted.

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