



Monthly Market Review

“We’re going to need a bigger helicopter.”

Economic Highlights

- The pandemic continues to drive the economy. A sharp drop in COVID-19 cases and an accelerated vaccine rollout boosted economic activity in the U.S. in February. With a newly approved vaccine from Johnson & Johnson and a unique partnership with Merck to support expanded manufacturing capacity, funded by the U.S. Department of Health and Human Services, President Biden promised “enough vaccine supply for every adult in America by the end of May” — a two-month acceleration of previous projections.
- The Biden Administration also made moves on other fronts: filling key cabinet positions, committing resources to the reunification of separated families, initiating a review of American supply chain risks, marshaling a \$1.9 trillion pandemic relief package through Congress, supporting voting rights reforms, and beginning efforts to address the need to invest in modern and sustainable American infrastructure.
- Consumer spending surged in January, led by a shift toward discretionary categories, after a disappointing December. Retail sales rose at the fastest pace in seven months, reflecting both the immediate impact of direct payments from the December COVID-19 \$900 billion relief package and pent-up consumer demand.
- Inflation expectations continued to rise as gauged by inflation breakeven rates derived from the difference between yields on fixed-rate Treasuries and those on Treasury Inflation-Protected Securities (TIPS) with comparable maturities. But actual measured inflation continued to lag behind the Federal Reserve’s (Fed) average target rate of 2%.
- In congressional testimony, Fed Chair Jerome Powell commented that “the economy is a long way from employment and inflation goals” and reaffirmed the Fed’s commitment to maintaining the accommodative monetary policy until the economy has recovered further from the pandemic. Near-zero interest rates and asset purchases remain in place for the foreseeable future.
- Chair Powell and other Fed governors seem to have shifted their focus on labor market conditions from narrow measures of jobs and the unemployment rate to broader labor market health measures. Though the U.S. economy added 379,000 jobs and the unemployment rate fell to 6.2% in February, the central bank is concerned that the total non-farm employment is nine million jobs lower than a year ago. Meanwhile, 18 million people are still collecting some form of unemployment benefits.
- The newest installment of a COVID-19 fiscal package, the American Rescue Plan, provides \$1.9 trillion of funding that includes \$1,400 stimulus checks to individuals, an extension of unemployment benefits, additional aid for small businesses and \$350 billion for state and local governments.

Bond Markets

- Bond market volatility surged over the month, and long-term interest rates rose as investors anticipate that strong growth will spur inflation. The result affected all financial markets with bonds, stocks and commodities moving to the same music.

- Shorter-term yields (less than two years) remained stable, shackled by the Fed’s near-zero rate policy, while the 10-year Treasury yields jumped over 30 basis points (bps). With the notable steepening of the yield curve the spread between the 2- and 10-year Treasury yields (120 bps) ended the month just shy of its widest level in five years and a far cry from the curve a year ago when spreads were 30 bps.
- The sharp upward movement in long-term rates led long-maturity securities to sink in value and depressed returns in longer-maturity portfolios. The 3-month Treasury benchmark returned 0.01%, while the 2- and 10-year indices recorded losses of 0.04% and 3.16%, respectively.

Equity Markets

- Equities rebounded in February – reaching new record highs – and weathered a minor pullback late in the month brought on by rising yields. For the month, the S&P 500 advanced 2.8% and the Nasdaq rose 1.0%; while the Dow Jones Industrial Average jumped 3.4%.
- Global equity markets rose as well, with the MSCI index of developed markets other than the U.S. up 2.57% and a broader index of all equities up 2.69%.

PFM Strategy Recap

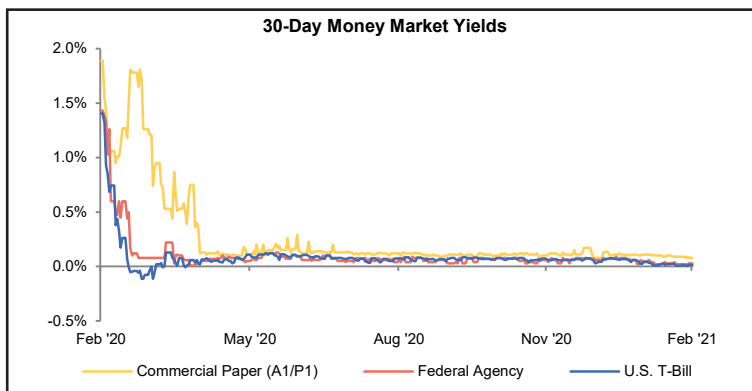
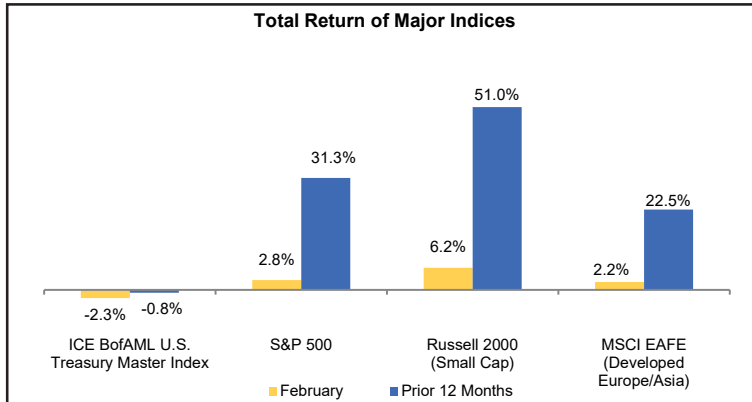
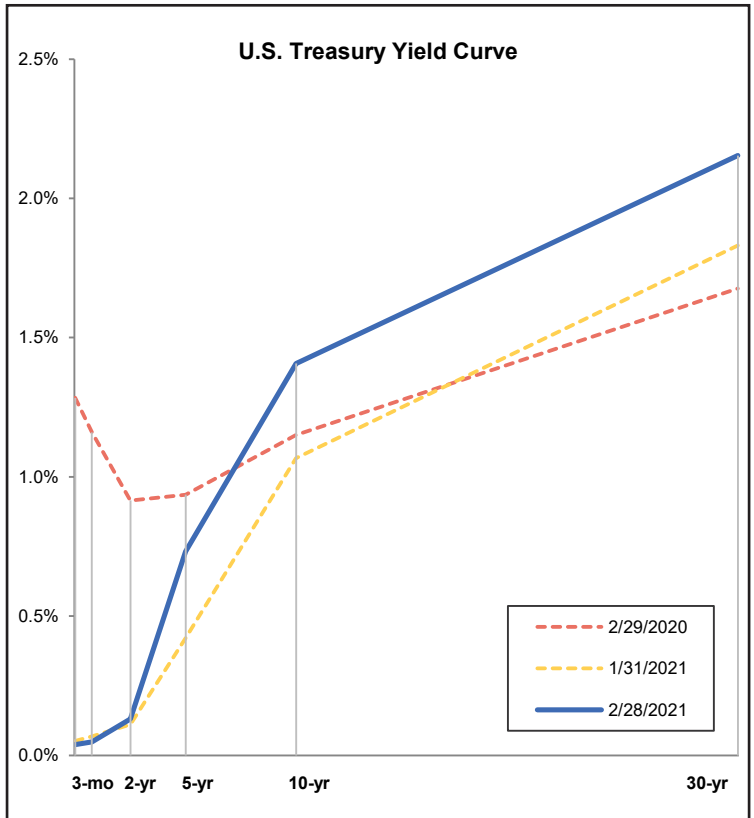
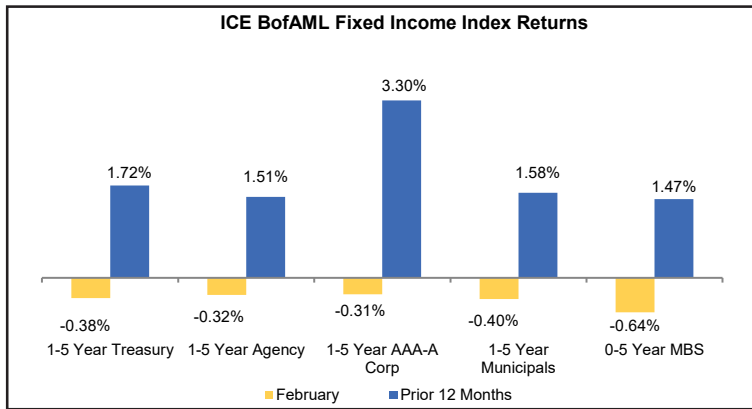
- With the economy poised for strong growth and the pandemic receding — for now — the focus is on the Fed. Fed Chair Powell has downplayed inflation concerns, underscoring a determination to maintain an easy money policy for the time being. We think the Fed’s policy will limit but not eliminate the trend to higher rates. We shifted our duration stance at the end of January to the shorter, more conservative side and recommend that portfolios be positioned to match but not exceed benchmark durations and limit out-of-benchmark maturity investments. For longer-maturity portfolios we recommend a modestly short duration.
- In the agency sector, supranational yields are attractive versus those on domestic federal agency securities whose income return versus Treasuries is nil. We recommend increasing allocations to supranationals.
- Investment-grade (IG) corporate bonds offer modest value as compared with the recent past. Yield spreads are now near multi-year lows. We prefer reduced allocations to the sector while continuing to seek attractively priced new issues selectively.
- AAA-rated asset-backed securities have experienced strong demand, although value remains sparse. Meanwhile, mortgage-backed security prepayments remain a notable headwind. We recommend trimming holdings in both sectors.
- In money markets, credit spreads widened a few basis points in February, and the short-term credit curve steepened just a bit, providing marginally better opportunities for short-term investors. But short-term Treasury Bill yields continued to fall on strong supply/demand dynamics.

U.S. Treasury Yields				
Duration	Feb 29, 2020	Jan 31, 2021	Feb 28, 2021	Monthly Change
3-Month	1.28%	0.05%	0.04%	-0.01%
6-Month	1.16%	0.07%	0.05%	-0.02%
2-Year	0.92%	0.11%	0.13%	0.02%
5-Year	0.94%	0.42%	0.73%	0.31%
10-Year	1.15%	1.07%	1.41%	0.34%
30-Year	1.68%	1.83%	2.15%	0.32%

Yields by Sector and Maturity as of February 28, 2021				
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	0.04%	0.02%	0.18%	--
6-Month	0.05%	0.02%	0.20%	--
2-Year	0.13%	0.16%	0.31%	0.41%
5-Year	0.73%	0.72%	0.98%	0.74%
10-Year	1.41%	1.51%	2.01%	1.40%
30-Year	2.15%	2.13%	3.07%	1.97%

Spot Prices and Benchmark Rates				
Index	Feb 29, 2020	Jan 31, 2021	Feb 28, 2021	Monthly Change
1-Month LIBOR	1.52%	0.12%	0.12%	0.00%
3-Month LIBOR	1.46%	0.20%	0.19%	-0.01%
Effective Fed Funds Rate	1.58%	0.07%	0.07%	0.00%
Fed Funds Target Rate	1.75%	0.25%	0.25%	0.00%
Gold (\$/oz)	\$1,567	\$1,847	\$1,729	-\$119
Crude Oil (\$/Barrel)	\$44.76	\$52.20	\$61.50	\$9.30
U.S. Dollars per Euro	\$1.10	\$1.21	\$1.21	\$0.00

Economic Indicators				
Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales Advance MoM	17-Feb	Jan	5.3%	1.1%
Consumer Confidence	23-Feb	Feb	91.3	90.0
GDP Annualized QoQ	25-Feb	4Q S	4.1%	4.2%
PCE Core Deflator YoY	26-Feb	Jan	1.5%	1.4%
ISM Manufacturing	1-Mar	Feb	60.8	58.9
Change in Nonfarm Payrolls	5-Mar	Feb	379k	200k
Unemployment Rate	5-Mar	Feb	6.2%	6.3%



Source: Bloomberg. Data as of February 28 2021, 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, PFM 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 is the marketing name for a group of affiliated companies providing a range of services. All services are provided through separate agreements with each company. Investment advisory services are provided by PFM Asset Management LLC, which is registered with the SEC under the Investment Advisers Act of 1940. For more information regarding PFM's services or entities, please visit www.pfm.com.

