CHANDLER ASSET MANAGEMENT

# BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

FEBRUARY 2022

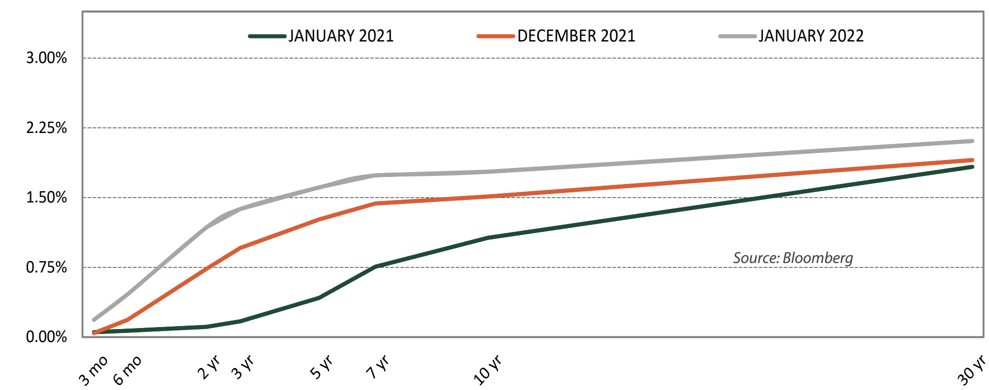
## Market Summary

As a result of less US fiscal support and a reduction of monetary accommodation by the Federal Reserve (Fed), we believe economic growth in 2022 is likely to moderate but will remain above-trend. We expect the healthy labor market will help drive economic growth this year as the critical health situation improves globally. Consumer spending, the largest component of US GDP, should also remain solid, supported by healthy consumer balance sheets and a potential shift in spending toward more services rather than goods. Over the near-term, we expect financial market volatility to remain elevated with heightened geopolitical risk, persistent inflation due in part to supply chain bottlenecks, and the Fed's pivot to less accommodative monetary policy. Inflation readings continue to run hot, however we believe inflation may be at or near a peak, while pricing pressures are likely to abate as we move through the year but are expected to remain above pre-pandemic levels.

The Federal Open Market Committee (FOMC) kept the fed funds target rate unchanged in January, in a range of 0.0% - 0.25%, although they indicated that they believe it will soon be appropriate to raise the target range. The Fed is also on track to complete their bond-buying program in early March. In addition, the FOMC is signaling that a passive reduction in the size of the Federal Reserve balance sheet is likely to commence later this year. The tone of Fed Chair Powell's press conference was hawkish, but he did not give any specific timelines. He mentioned that his outlook for inflation is incrementally worse than it was in December and that supply chain issues will linger for longer than previously expected. The Fed's policy decisions will be led by incoming economic data and their evolving outlook. We are anticipating a rate hike announcement in March, but we do not believe that monetary policy is on a pre-set course and expect the Fed's policy adjustments will depend on developments in the economy.

In January, the 2-year Treasury yield increased nearly 45 basis points to 1.18%, the 5-year Treasury yield increased almost 35 basis points to 1.61%, and the 10-year Treasury yield increased about 27 basis points to 1.78%. On a month-over-month basis, the yield curve flattened. The spread between the 2-year and 10-year Treasury yield was roughly 60 basis points at January month-end, versus 78 basis points one month ago and 96 basis points one year ago. We believe there will likely be an upward bias on Treasury yields but much of the anticipated rate hikes in the federal funds rate by the Federal Reserve have been priced into the market.

### TREASURY YIELDS CONTINUED TO RISE IN JANUARY




Yields continued to move higher across the curve in January; the 3-month T-bill yield was up 15 basis points to 0.18% in the month and the 2-Year Treasury yield increased 45 basis points to 1.18% as the Federal Reserve continues to signal multiple hikes in the federal funds rate in 2022, with the first likely to occur at its March meeting. Further out the yield curve, the move higher in interest rates was more muted with the 10-Year Treasury yield increasing approximately 27 basis points to 1.78% for the month. We believe there will likely be an upward bias on Treasury yields but most of the anticipated rate hikes in the federal funds rate by the Federal Reserve have been priced into the market.

| TREASURY YIELDS | Trend (▲/▼) | 1/31/2022 | 12/31/2021 | Change |
|---|---|---|---|---|
| 3-Month | ▲ | 0.19 | 0.04 | 0.14 |
| 2-Year | ▲ | 1.18 | 0.73 | 0.45 |
| 3-Year | ▲ | 1.38 | 0.96 | 0.42 |
| 5-Year | ▲ | 1.61 | 1.26 | 0.35 |
| 7-Year | ▲ | 1.74 | 1.44 | 0.30 |
| 10-Year | ▲ | 1.78 | 1.51 | 0.27 |
| 30-Year | ▲ | 2.11 | 1.90 | 0.21 |

*Source: Bloomberg*

## Market Data

*World Stock Market Indices*
*data as of 1/31/2022*

| | Change (12/31/21) | %CHG |
|---|---|---|
| **S&P 500** | | |
| **4,515.55** | -250.63 | -5.26% |
| **NASDAQ** | | |
| **14,239.88** | -1,405.09 | -8.98% |
| **DOW JONES** | | |
| **35,131.86** | -1,206.44 | -3.32% |
| **FTSE (UK)** | | |
| **7,464.37** | 79.83 | 1.08% |
| **DAX (Germany)** | | |
| **15,471.20** | -413.66 | -2.60% |
| **Hang Seng (Hong Kong)** | | |
| **23,802.26** | 404.59 | 1.73% |
| **Nikkei (Japan)** | | |
| **27,001.98** | -1,789.73 | -6.22% |

*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 Tightened in December

| CREDIT SPREADS | Spread to Treasuries (%) | One Month Ago (%) | Change |
|---|---|---|---|
| 3-month top rated commercial paper | 0.11 | 0.07 | 0.04 |
| 2-year A corporate note | 0.20 | 0.16 | 0.03 |
| 5-year A corporate note | 0.52 | 0.40 | 0.12 |
| 5-year Agency note | 0.03 | 0.02 | 0.01 |

*Source: Bloomberg*

Data as of 1/31/2022

## Supply and Demand Imbalances Continue to Impact Economic Data

| ECONOMIC INDICATOR | Current Release | Prior Release | One Year Ago |
|---|---|---|---|
| Trade Balance | (80.73) $Bln DEC 21 | (79.33) $Bln NOV 21 | (65.80) $Bln DEC 20 |
| Gross Domestic Product | 6.90% DEC 21 | 2.30% SEP 21 | 4.50% DEC 20 |
| Unemployment Rate | 4.00% JAN 22 | 3.90% DEC 21 | 6.40% JAN 21 |
| Prime Rate | 3.25% JAN 22 | 3.25% DEC 21 | 3.25% JAN 21 |
| Commodity Research Bureau Index | 255.12 JAN 22 | 232.37 DEC 21 | 174.20 JAN 21 |
| Oil (West Texas Int.) | $88.15 JAN 22 | $76.99 DEC 21 | $52.20 JAN 21 |
| Consumer Price Index (y/o/y) | 7.50% JAN 22 | 7.00% DEC 21 | 1.40% JAN 21 |
| Producer Price Index (y/o/y) | 12.20% DEC 21 | 13.30% NOV 21 | (0.80%) DEC 20 |
| Euro/Dollar | 1.12 JAN 22 | 1.14 DEC 21 | 1.21 JAN 21 |

*Source: Bloomberg*

## Economic Roundup

### Consumer Prices

U.S. consumer prices rose more than expected in January as inflation reached levels not seen since 1982. The Consumer Price Index (CPI) was up 7.5% year-over-year in January, versus up 7.0% year-over-year in December. Core CPI (CPI less food and energy) was up 6.0% in January, versus up 5.5% year-over-year in December. Pricing pressures were widespread in January; energy, rents and food prices remained elevated from the prior month. The Personal Consumption Expenditures (PCE) index was up 5.8% year-over-year in December, up from 5.7% in November. Core PCE was up 4.9% year-over-year in December, versus up 4.7% in November. Current inflation readings continue to run above the Fed's longer-run target of around 2.0%. Although we believe year-over-year inflation may be at or near a peak and pricing pressures are likely to abate as we move through the year, we expect inflationary pressures will remain elevated over the near-term.

### Retail Sales

On a year-over-year basis, retail sales were up 16.9% in December versus up 18.2% in November. On a month-over-month basis, retail sales were weaker than expected in December, down 1.9% versus expectations of down 0.1%, following a modest gain of just 0.2% in November. Excluding vehicles and gas, retail sales were down 2.5% month-over-month. In our view, the data suggests consumers started shopping early in the holiday season and that high gas prices have been taking a larger share of consumer's disposable income. We believe the surge in Omicron cases hindered December sales and will likely take a toll on January retail sales as well. In spite of this, we remain constructive on the outlook for consumer spending this year. Looking further ahead, we believe high levels of consumer savings along with improvements in the health situation and labor market should provide tailwinds for consumer spending.

### Labor Market

The January employment report was strong with US nonfarm payrolls increasing 467,000, well above the consensus forecast of 125,000. Payrolls in the prior two months were revised significantly higher and on a trailing 3-month and 6-month basis payrolls have increased an average of about 540,000 per month. The unemployment rate edged slightly higher to 4.0% in January from 3.9% in December as more workers entered the labor force. The labor participation rate increased to 62.2% in January from 61.9% in December but remains lower than the pre-pandemic level of 63.4%. 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 7.1% in January from 7.3% in December, and is very close to its pre-pandemic level (7.0% in February 2020). Average hourly earnings rose 0.7% month-over-month and were up 5.7% year-over-year in January versus 4.9% in December. The labor market remains tight which is supportive of higher wages for the remainder of the year.

### Housing Starts

Total housing starts increased 1.4% in December to an annual pace of 1,702,000. Single-family starts declined 2.3% while multi-family starts increased 10.6%, month-over-month. On a year-over-year basis, total housing starts were up 2.5% in December. According to the Case-Shiller 20-City home price index, home prices were up 18.3% year-over-year in November versus up 18.5% year-over-year in October, suggesting the acceleration in home prices is easing. However, tight supply will likely continue to support prices.

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.