Monthly Market Review

Fixed Income | November 2023

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

IPDLAF+ CLASS

"Pause, Pauser, Pausing, Paused…Passé?"

Economic Highlights

► The Federal Reserve (Fed) held the benchmark overnight target rate unchanged at its current range of 5.25% to 5.50% at the conclusion of its meeting on November 1. Fed officials have now skipped a rate hike for two consecutive meetings. The Fed noted that while job gains have moderated, the labor market remains strong, while also noting inflation remains elevated. Fed Chair Jerome Powell characterized policy risks as "getting more balanced." The market's response was to price out any further rate hikes and pull forward the first potential rate cut in 2024.

► The October employment report came in below estimates as non-farm payrolls increased by only 150,000. The unemployment rate ticked up to 3.9% from 3.8% the prior month and a cycle low of 3.4% in April. The labor force participation rate inched lower (to 62.7%), the first monthly decline since October 2022. The Fed's goal of loosening the labor market appears on track.

► The Consumer Price Index (CPI) for September increased 3.7% on a year-over-year basis. Core CPI (which excludes volatile food and energy prices) increased 4.1% over the past 12 months. Although still firmly above the 2% target set by the Fed, core inflation has continued to trend lower.

► The advance estimate of U.S. real gross domestic product (GDP) showed economic growth increased at an annual rate of 4.9% in the third quarter, firmly beating surveys and more than doubling the 2.1% rise in the second quarter. This reflected increases in most categories, except business equipment spending. Consumer spending was particularly strong at 4% growth, but 1.3% of overall GDP was from increases in inventories, which are usually reversed over time.

► A myriad of headwinds are mounting, including still-elevated prices, the resumption of student loan payments, stock market volatility and near 8% mortgage rates. Coupled with declining real household income and lower personal savings rates, the consumer's willingness to continue spending will be key to achieving a 'soft landing'.

► The federal budget deficit for fiscal year 2023 was $1.7 trillion, a 23% increase from the prior year. Total outlays fell, but revenues declined by more as individual income tax fell by 17%. Net interest on the public debt increased by $177 billion. The U.S. Treasury announced it expects funding needs for the next six months to be $1.59 trillion, representing a reduction relative to its initial estimates.

Bond Markets

► U.S. Treasury yields finished higher across the curve in October. The 30-year bond led the way, increasing 39 basis points (bps) over the month to finish at 5.09%. The benchmark 2-, 5-, and 10-year U.S. Treasuries finished the month at 5.09%, 4.85%, and 4.93%, moving up 4, 24, and 36 bps, respectively.

► As a result, the curve steepened (became less inverted) as the spread between the 10- and 2-year U.S. Treasury notes ended the month at -16 bps, the narrowest inversion over the past year.

► Yield increases on longer maturities led longer duration strategies to underperform notably. In October, the ICE BofA 2-, 5-, and 10-year Treasury indices returned 0.33%, -0.55%, and -2.22%, respectively.

► Market-wide de-risking themes from the last week of September carried through October, pushing yield spreads wider across most fixed income asset classes. As a result, diversification away from U.S. Treasuries was generally a detractor from portfolio performance as excess returns were firmly in the red.

Equity Markets

► Equities finished the month negative as prices continued to trend lower from July highs. The S&P 500 and Nasdaq wrapped up their worst October since 2018. The S&P 500 fell 2.1%, the Dow Jones Industrials fell 1.3%, while the Nasdaq declined by 2.8%. International stocks fared worse, with the MSCI ACWI ex-US index falling 4.1%.

► After two months of steep increases, the U.S. dollar Index (DXY) gained a modest 0.5% in October as markets priced for an extended Fed pause.

PFMAM Strategy Recap

► With the Fed at or very near the end of its current hiking cycle, economic data showing some softening, and the yield curve steepening beyond three years, we plan to bring portfolio durations closer to benchmarks. However, given the curve is still inverted out to five years, we will do so cautiously.

► Value in agencies, supranationals and municipals remains quite limited. Spreads are on the tighter end of their recent ranges and issuance has been light.

► Corporates underperformed in October as spreads increased to six-month highs. Good fundamentals, high yields, wider spreads and a positive economic outlook support a constructive view on the sector.

► The asset-backed security (ABS) sector underperformed in October, as spreads are now near their March wides. AAA-rated senior tranches offer good risk/return value.

► Mortgage-backed securities (MBS) have underperformed badly this cycle but are now at the cheapest spread levels in a long time. Agency CMBS continues to offer value.

► Money market credit yields (commercial paper and bank certificates of deposit) continue to hover near 6% in 9- to 12-month maturities, offering strong income potential.

U.S. Treasury Yields

Duration	Oct 31, 2022	Sep 30, 2023	Oct 31, 2023	Monthly Change
3-Month	4.07%	5.45%	5.47%	0.02%
6-Month	4.54%	5.55%	5.57%	0.02%
2-Year	4.49%	5.05%	5.09%	0.04%
5-Year	4.23%	4.61%	4.86%	0.25%
10-Year	4.05%	4.57%	4.93%	0.36%
30-Year	4.17%	4.70%	5.10%	0.40%

Yields by Sector and Maturity

Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	5.47%	5.39%	5.71%	-
6-Month	5.57%	5.44%	5.72%	-
2-Year	5.09%	5.15%	5.51%	3.70%
5-Year	4.86%	4.94%	5.47%	3.42%
10-Year	4.93%	5.20%	5.77%	3.65%
30-Year	5.10%	5.53%	6.19%	4.26%

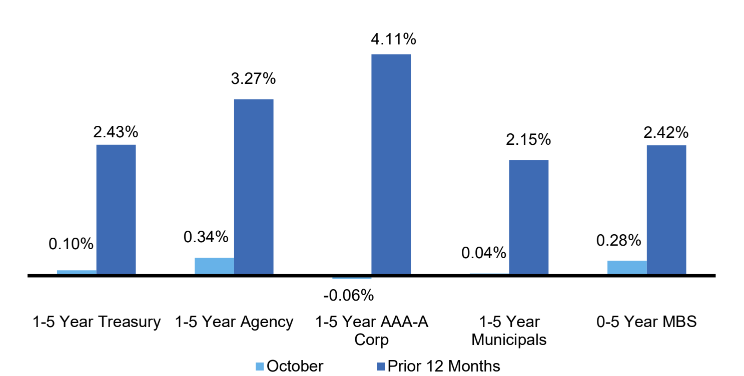
Spot Prices and Benchmark Rates

Index	Oct 31, 2022	Sep 30, 2023	Oct 31, 2023	Monthly Change
1-Month LIBOR	3.80%	5.43%	5.43%	0.00%
3-Month LIBOR	4.46%	5.66%	5.64%	-0.02%
Effective Fed Funds Rate	3.08%	5.33%	5.33%	0.00%
Fed Funds Target Rate	3.25%	5.50%	5.50%	0.00%
Gold ($/oz)	$1,641	$1,848	$1,994	$146
Crude Oil ($/Barrel)	$86.53	$90.79	$81.02	-$9.77
U.S. Dollars per Euro	$0.99	$1.06	$1.06	$0.00

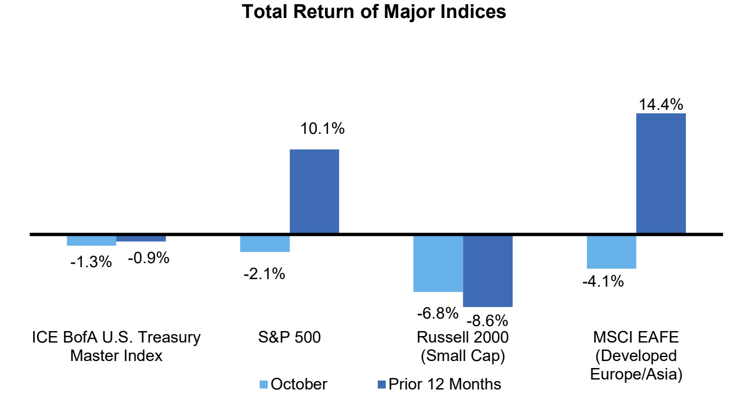
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
CPI YoY	12-Oct	Sep	3.70%	3.60%
Retail Sales Advance MoM	17-Oct	Sep	0.70%	0.30%
GDP Annualized QoQ	26-Oct	3QA	4.90%	4.50%
U. of Mich. Consumer Sentiment	27-Oct	Oct F	63.8	63
PCE Core Deflator YoY	27-Oct	Sep	3.70%	3.70%
FOMC Rate Decision	1-Nov	Nov	5.50%	5.50%
ISM Manufacturing	1-Nov	Oct	46.7	49

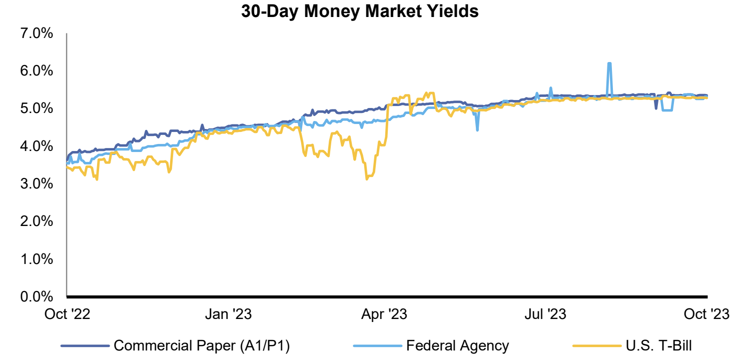
ICE BofA Fixed Income Index Returns



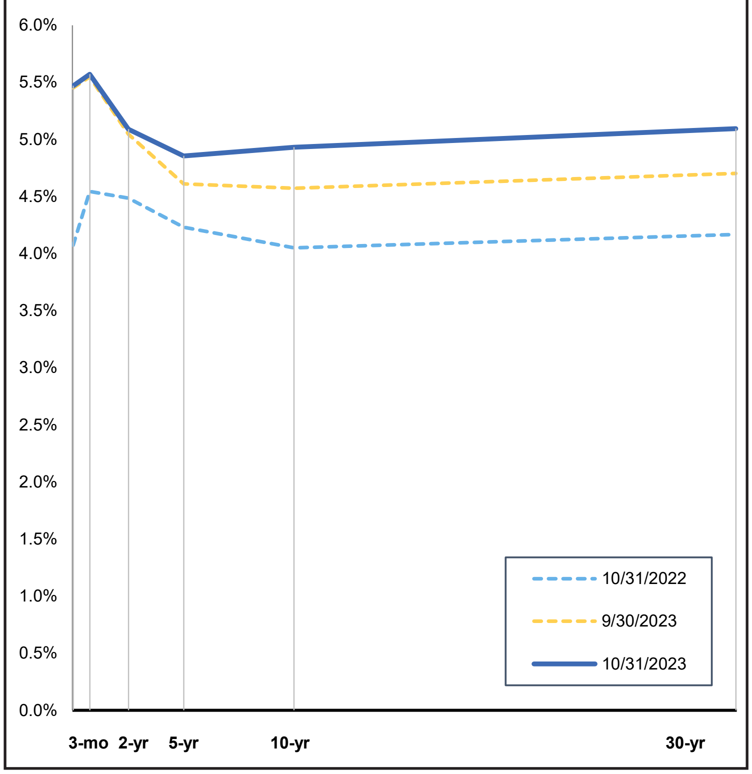
Total Return of Major Indices



30-Day Money Market Yields



U.S. Treasury Yield Curve



Source: Bloomberg. Data as of October 31, 2023, unless otherwise noted.

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