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Fixed Income Market Review - February 2023

As we have left 2022, the worst calendar year return for the bond market in history, what is ahead for 2023? The market believes inflation is still a major risk, and if not inflation, then a recession. In the face of these economic concerns, with Germany, England and the US sending tanks to the Ukraine to counter the Russian invasion, the doomsday clock is shifting ever closer to midnight.

Please note though rates are much higher this month compared to last month, the yield curve continues to be very inverted between not only the 2 and 10-year, but also between the 2-year and 30-year.

US Yield Levels

Date	2-year	10-year	30-year
2/28/23	4.81%	3.92%	3.93%
1/31/23	4.21%	3.52%	3.65%
12/30/22	4.41%	3.88%	3.97%
11/30/22	4.38%	3.68%	3.80%
10/31/22	4.51%	4.10%	4.22%
9/30/22	4.22%	3.83%	3.79%
8/31/22	3.45%	3.15%	3.27%
7/29/22	2.89%	2.67%	3.00%
6/30/22	2.92%	2.98%	3.14%
5/31/22	2.53%	2.85%	3.07%
4/29/22	2.70%	2.89%	2.96%
3/31/22	2.28%	2.32%	2.44%
2/28/22	1.44%	1.83%	2.17%
1/31/22	1.18%	1.79%	2.11%
12/31/21	0.73%	1.52%	1.77%
12/31/20	0.13%	0.93%	1.65%
12/31/19	1.58%	1.92%	2.39%

***Source US Treasury Department**

Bloomberg Barclay's Fixed Income Index Returns

Though Index returns had been positive for January, with the Fed actively tightening they returned in February to being very negative.

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Index	Feb 2023	Last 3 Months	Last 12 months
Aggregate	-2.59%	-0.04%	-9.72%
Int Agg	-2.07%	-0.03%	-7.22%
Gov't/Credit	-2.59%	-0.14%	-10.06%
Int Gov't/Credit	-1.80%	-0.14%	-4.22%
Gov't	-2.31%	-0.40%	-9.96%
MBS	-2.57%	0.18%	-8.94%
ABS	-0.85%	1.22%	-2.60%
CMBS	-1.87%	0.72%	-7.72%
US Credit	3.01%	0.26%	-10.15%
US Corp High Yield	-1.29%	1.83%	-5.46%

February Economic News

Just as it was the last two months, the primary question of the market remains, are we heading into a recession? Repeating from December's Review, on December 2nd the Department of Labor reported 263,000 jobs were added during November. The Unemployment rate for November held steady at 3.7%. Payroll gains for September were revised down by 46,000 to 269,000 but October was revised up by 23,000 to 284,000. As stated in that December Review the Labor market seemed solid to me.

Then on January 2nd the Department of Labor reported nonfarm payrolls increased by 223,000 during December. The November number was revised down but only by 7.000 from the initial estimate. The unemployment rate fell by 0.2% to stand at 3.5%. Average hourly wages were reported to be up by 0.3% for the month and 4.6% on a yearly basis. This is good in being positive but not too high.

Ahead of the January jobs report on February 1st the Fed hiked rates again but just by ¼%, the smallest increase in its current tightening cycle. In the news release that accompanied this hike announcement the Fed stated, "Inflation has eased somewhat but remains elevated." It also stated the US economy was enjoying "modest growth" and "robust" job gain.

On February 3rd the unemployment report supported the Fed statement of "robust" job gains. The report announced nonfarm payrolls increased by a huge 517,000 in January. The unemployment rate fell to a historic low of 3.4%. The only other time the rate was this low was 1969. Of note, the unemployment rate among Black Americans fell to 5.4%, its lowest level in history.

At basically the same time the US Labor Department issued its monthly JOLTS report indicating job openings had increased by 572,000 to reach 11.0 million as of the last day of December. From strictly the standpoint of the labor markets, a recession can't be further from the point of a risk.

As to inflation, on January 9th the NY Fed reported its December Survey of Consumer Expectations indicating US households expect weaker near-term inflation and are expecting to do significantly less spending even as they expect incomes to continue to rise. The survey projected inflation at 3% per year for the next three-year period and at 2.4% per year for the upcoming five-year period.

As to the CPI, it was reported with a 0.1% decline for the month of December with an increase of 6.5% from a year earlier, down from a 7.1% yearly number in November. The Core CPI saw a 0.3% increase which lowered the annual core increase from 6% to 5.7%.

However, on February 10th the December reports of US consumer prices for December were corrected from a fall in prices to a rise. The previously reported decline of 0.1% for December was revised to a 0.2% increase. Also, the October CPI was revised up from a 0.4% to a 0.5% increase.

On February 14th it was reported for January the CPI rose 6.4% from a year ago, down only slightly from the 6.5% rise through December. Categories that saw increases for January include motor vehicle insurance, recreation, apparel and household furnishings with declines for used cars and trucks, medical care and airline fares. Among those rising on a year-over-year basis were fuel oil up 27.2%, home gas service up 26.7%, frozen vegetables up 18.6%, lettuce up 17.2%, eggs up 70.1%, butter up 32.5%, lettuce up 17.2%, cereal up 15.6%, pet food up 15.1% and electricity up 11.9%. Also rising were rent of primary residences up 8.6% and food away from homes up 8.2%. All items less food and energy were up 5.6%. The increase in rent costs was the highest annualized rate since 1982.

On February 14th the White House touted the fact the unemployment rate was at its lowest level since 1969 and over 1.2 million jobs have been created since President Biden took office. This ranks as the fastest jobs recovery from a recession in three decades. Touted were the fact 800,000 new manufacturing jobs were created in the last two years and wages adjusted for inflation were higher at the time of the news conference than the prior June.

Producer prices were reported to have risen 6% for twelve months through January. This was just slightly lower than the 6.5% number through December.

As to the consumer, on February 15th AP Economics reported consumer spending rose in January by the fastest pace in 2 years. Retails sales increased by 3% in January, the largest one month increase since March 2021. The largest contributing factor was car sales.

Restaurant spending was up 7.2% in the month of January and 25% for the last twelve-month period including a rise of 8% in restaurant prices. Responding to the retail sales, consumer spending and jobs reports, Goldman reduced its risk of a recession from 35% to 25%. I continue to believe they are too high.

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As to the housing market, on February 18th Zillow reported inventories of homes for sale are climbing but are below pre-covid levels. Zillow also reported owners of homes have less onerous mortgages with 85% of home mortgages being under a rate of 5%. Goldman reduced its estimates of declines in home prices to 6% from 10% over the upcoming year. Existing home sales which were averaging 6.5 million a year in early 2021 have declined to the current 4 million a year. Delinquency rates on home mortgages have fallen to less than 0.7% of mortgages.

The housing market is generally stable but very differentiable, especially as to affordability by market location. The new home building market is not going to be a leader in the continued economic expansion as people will be staying put with low mortgage interest rates. Existing home sales during January fell to their lowest level in 12 years.

On February 24th the US Commerce Department reported the PCE rose by 5.4% for the year through January. This compared with the 5.3% rise for the 12-month period through December. The monthly gain in December was 0.2% while in January it was 0.6%. The Core PCE rose 0.6% in December and 4.7% for the twelve-month period.

Though consumer spending had increased in January by 0.6%, consumers increased their personal savings rate by 0.2% to 4.7% total. Running counter to this increase in savings, the New York Federal Reserve Bank's Quarterly Report on Household Debt reported credit card balances had increased in the 4th Quarter of 2022 by $61 billion, to $986 billion, a historic high up from $927 billion before the pandemic. The share of credit card users making payments that were at least 30-days late rose from 5.2% to 5.9%. The percentage of serious credit debts of at least 90 or more days late rose to 4% from 3.7% the previous quarter.

On February 28th WalletHub reported US Households were $17 trillion in total debt, equal to $142,680 per household. This latest number represents roughly $320 billion more in total debt than at the start of 2022, with $398 million in new debt having been added in the fourth quarter. WalletHub estimates approximately 70% of this total debt is mortgage debt.
As an often overlooked tool being used by the Federal Reserve, it was reported on February 28th M2 money supply dropped during 2022 by its largest year-over-year decline in history.

February Cryptocurrency

On February 8th Binance announced it was suspending US dollar withdrawals for international customers. Millions of dollars of crypto flowed out of Binance but the company declared it remained "net-positive". This activity applies only to non-US customers who transfer money to or from bank accounts in dollars. Using data from DefiLlama, net outflows totaled $172 million for the day, relatively insignificant for a company holding $42.2 billion in crypto assets.

Another new name has emerged, this being Polygon. It is a blockchain firm that operates in conjunction with Ethereum. Its future success is to me much in question, but it has already

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established business arrangements with Starbucks and Mastercard. It is a firm in the crypto-world worthy of watching.

A Personal Observation

I am repeating much of this segment from last month's Review with China being so significant in February news.

Having grown up in the 50's and 60's, I always considered the center of the automobile industry to be Detroit with Ford, General Motors and to a lesser degree Chrysler being the foundation of that universe. That focus began to weaken when soon after my wife and I married, we bought a Japanese Mazda which we appreciated being able to climb any mountain of snow, since we had not yet moved from the Buffalo area. Even years later when my fixed income shop Allegiance Capital was in a finals to manage Ford Motor assets, I was highly impressed by the Ford dominated parking lot at Ford in Detroit and how dumb I had been to drive a foreign rental car into that lot.

But on January 23rd I read a Businessweek article stating China is poised to become the number 2 exporter of passenger vehicles, having gone by the US and South Korea to third place, and about to exceed Germany for second place. Japan remains in first place.

The article states overseas shipments of cars in China have tripled since 2020 to reach 2.5 million last year. This places China ahead of the US and South Korea, and just slightly behind Germany, with Japan in the lead. The article goes on to state Chinese brands are the leaders in the Middle East and Latin America. China's stated target is to sell 8 million vehicles a year by 2030.

Does the US have any similar goal? I would suggest not and believe it is a major competition problem we in the US need to begin addressing.

Staying with China but moving beyond the automobile industry, on January 13th Goldman Sachs raised its growth forecast for 2023 for China's economy from 4.5% to 5.3%. Goldman does expect this increased growth will add to inflation but only to 1.9% for China in 2023.

Since last month's Review, Goldman has now raised China's projected 2023 growth rate to 6.5%. Goldman expects that China's reopening will increase domestic Chinese demand by 5%, should increase China's travel trade deficit and likely increase China's oil demand by 1 million barrels a day, resulting in a $15 to $21 increase per barrel in oil prices. Though such an increase will negatively impact many economies, it would be a boon for net oil exporters Canada and some of the Latin American countries.

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My Economic Outlook

On February 2nd the Federal Reserve did again increase interest rates, but by its smallest increase in the current cycle at ¼%. It did indicate the Fed is not yet done but I fully expect it will at most be only one more increase. The Bank of England raised its key rate on February 1st by ½% but signaled it may soon pause.

I believe the Fed after one more increase will be finished raising rates. Inflation is likely done. The US housing market is basically stable and personal spending has begun to recover from the pandemic, and though credit card debt is high, the US economy will almost certainly not enter a recession.

Bob Southard
On Behalf of Greenrock Research March 2, 2023

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