



Positive market momentum spilled over from the fourth quarter of 2022 into the first quarter of 2023 but not without multiple changes in economic sentiment from “soft-landing” to “no-landing” to “hard-landing” and back to “soft-landing”. Throughout the first quarter, recession probabilities increased, credit conditions tightened, and the Fed downshifted to quarter point rate hikes. On January 19th the Treasury announced the U.S. had reached the \$31.4 trillion debt ceiling, causing a “debt issuance suspension period”, and “extraordinary measures” were necessary to borrow additional funds. The Congressional Budget Office (CBO) projected that without changes to the debt limit, the U.S. will run out of funds sometime between July and September of 2023. In March a Banking crisis took center stage when Silvergate Bank, Silicon Valley Bank and Signature Bank all failed within a matter of five days, followed by significant rescue efforts to salvage First Republic Bank and Credit Suisse, Switzerland’s second largest bank. The FOMC met twice during the first quarter and raised the Fed Funds rate by 25 basis points at each meeting, increasing the target funds rate to 4.75 to 5.00%. Additionally, Chairman Powell confirmed the Fed’s monthly quantitative tightening program intended to continue reducing the Fed balance sheet by \$95 billion per month. However, in response to the bank failures, the Fed also created two bank backstop facilities and supported nearly \$165 billion in bank borrowing. The March FOMC highlighted the banking issues; “The U.S. banking system is sound and resilient. Recent developments are likely to result in tighter credit conditions for households and businesses and to weigh on economic activity, hiring, and inflation. The extent of these effects is uncertain. The Committee remains highly attentive to inflation risks.” U.S. Real Gross Domestic Product (GDP) increased at an annual rate of +2.6% during the fourth quarter of 2022, while nominal U.S. GDP (not adjusted for inflation) came in at 6.6% for the same period. Inflation, as measured by the U.S. Consumer Price Index (CPI), rose by 6.0% for the twelve-month period ending February 2023. The Bureau of Labor Statistics (BLS) reported the unemployment rate increased slightly in February to 3.6%, while the U-6 measure of total unemployed increased substantially to 7.3% but still below its 10.3% historical average. The Conference Board Consumer Confidence Index ended March at 104.2, down sharply from 109 in December.

Despite the volatility caused by the quarter’s bank failures, the S&P 500 returned +7.48% in the 1st quarter, while the tech-heavy NASDAQ 100 returned +20.77%. The Bloomberg U.S. Aggregate Index generated a positive return in the quarter of +2.96%. Credit spreads tightened modestly, as interest rates declined across the curve. The yield inversion between 2- and 10-year Treasuries remained steady, widening by 1 bps to -56 bps. The 2-year Treasury yield decreased by 40 bps to 4.03%, while the 10-year Treasury yield declined by 41 bps to finish the quarter at 3.47%. For the quarter Treasuries returned +3.01%. Investment grade (IG) corporate bonds were the top performing investment grade sector, returning +3.50%, and U.S. High Yield Corporate Bonds slightly outperformed investment grade bonds and returned +3.57%. All other sectors generated positive quarterly returns including U.S. Agency Securities (+2.26%), Government-Related Credit (+3.12%), Mortgage-backed Securities (+2.53%), Commercial MBS (+1.81%) and Asset-backed Securities (+1.86%).

PIA is confident the U.S. is heading for an economic contraction. However, the magnitude and timing of a NBER declared recession are unclear, with our mean estimate being a “growth recession” landing no sooner than year-end. That said, we have never seen a more anticipated economic downturn, with nearly every economic indicator pointing to an inevitable recession. The Conference Board Index of Leading Economic Indicators has declined eleven consecutive months and roughly 6% year over year, which is the largest pre-recession decline since the late 1960’s. The inversion of the 3-month to 10-year Treasury yield curve has flawlessly predicted future recessions with a 100% historical correlation, and this yield curve has been inverted since late October 2022. The ISM Purchasing Managers Index (PMI), a key component for predicting economic expansion/contraction, has declined 28% since March of 2021. Anecdotally, ten of the last thirteen rate hike cycles have resulted in recession. Yet, arguably the greatest economic challenge may prove to be current monetary policy, as Chairman Powell continues to restate his steely Volker-like resolve to definitively squash inflation to the Fed’s stated 2% target, which we believe remains out of reach, unless preceded by a broader and deeper recession than anticipated. Nonetheless, we anticipate at least one, but more likely



two quarter point rate hikes by June, followed by a lengthy pause with no rate cuts this year. Despite nine rate hikes and 5% higher rates over the past year, prior to the recent banking crisis, U.S. financial conditions had tightened very little since the onset of the current rate hike cycle.

We believe tighter lending standards and reduced availability of capital are the natural congruent outcome of a financial or banking crisis. If the recent bank failures are not reflective of systemic banking problems, we anticipate what PIA refers to as a “growth recession” characterized by a return to single-digit corporate profits, reduced inflation below wage growth levels, a modest increase in unemployment and moderation in consumer consumption. We anticipate the recent and long overdue blue collar wage improvements will remain sticky. Conversely, we anticipate asset values to gradually return to normal levels, i.e. historically normalized P/E multiples and eventually a return to net positive real bond yields. When the Fed has executed its current vision to normalize inflation, we expect structural inflation to remain in the 2.5-3% range due to additional producer cost layers associated with food and energy, an ongoing transition to alternative energy and a trend away from globalization to regional onshoring. Due to excessive covid-related financial support and circumstances, U.S. households and corporate balance sheets continue to be unusually healthy for this stage in an economic/monetary cycle. However, we believe

the Fed will need to hold the funds terminal rate at or above 5% for an extended period to get inflation down to/below the 3% level. This implies a paradigm shift for businesses that have been operating on 1-2% capital, and households that have operated as net spenders. Lastly, we believe our outlook for a “growth recession” is reasonably optimistic but could quickly turn negative due to geo-political events including, but not limited to, bad politics regarding the debt ceiling or conditions in the Ukraine-Russia region. Historically, event risks have created flights to quality leading to bond market rallies. However, either of these scenarios could lead to global destabilization coupled with higher interest rates.

In the first quarter, PIA maintained a short portfolio duration relative to our respective benchmarks, based on relative value. We modestly reduced our Investment Grade corporate weighting; however, we continue to overweight corporate debt with a focus on high quality issuers exhibiting strong balance sheets. Our Industrial credits provide incremental risk-adjusted yield and our Financials credits are senior domestic debt we believe offer attractive compensation for their sector volatility. In our Plus strategies, we modestly reduced our high yield credit exposure. We maintained a neutral-weighting in Agency MBS and collateralized debt but continue to evaluate opportunities to add to the sector.

PIA Investment Strategy Group



KEY RATES

	3/31/23	12/31/22	12/31/21
Fed Funds Target Rate	4.75-5.0%	4.25-4.5%	0.0-0.25%
3 Month LIBOR	5.19	4.77	0.21
On-the-run Treasuries:			
3 Months	4.69	4.34	0.03
6 Months	4.86	4.75	0.18
2 Years	4.03	4.43	0.73
5 Years	3.57	4.00	1.26
10 Years	3.47	3.88	1.51
30 Years	3.65	3.96	1.90

Source: Bloomberg

INDEX RETURNS

	1Q'23	YTD	1-Year
Bloomberg –			
Universal	2.93%	2.93%	-4.61%
Aggregate	2.96	2.96	-4.78
Gov-Credit	3.17	3.17	-4.81
Int. Gov-Credit	2.33	2.33	-1.66
Corporate	3.50	3.50	-5.55
Treasury only	3.01	3.01	-4.51
1-3 year Gov	1.59	1.59	0.23
ICE BofA – 1-yr T-Note	1.31	1.31	1.74
High Yield	3.57	3.57	-3.34
Global Aggregate	3.01	3.01	-8.07
Emerging Markets Debt	2.15	2.15	-4.64
S&P 500	7.48	7.48	-7.75
DJIA	0.93	0.93	-1.98
NASDAQ 100	20.77	20.77	-10.35
MSCI EAFE	8.65	8.65	-0.79

Source: Bloomberg

KEY ECONOMIC INDICATORS

	as of	3/31/23	12/31/22
U.S. \$ (DXY)		102.51	103.5
Oil		75.7	80.3
Gold		1,969.3	1,824.0
CRB		268.7	277.70
GDP		2.6	2.6
CPI		6.0	6.5
Core (Ex - Food & Energy)		4.7	4.6
Unemployment Rate		3.6	3.5
Consumer Confidence		104.2	109.0
S&P/Case-Shiller – Comp-20		2.6	4.7

Source: Bloomberg

SECTOR RETURNS

1Q'23	Total Return	Excess Return
U.S. Treasuries	3.01%	0.00%
Government-related U.S. Agency	2.88	-0.39
Government-related Credit	3.12	0.23
Corporate	3.50	-0.42
Corporate Financials	2.35	-1.49
Corporate Industrials	4.12	0.19
Corporate Utilities	3.78	-0.27
Corporate AAA-rated	5.03	0.56
Corporate AA-rated	3.95	0.22
Corporate A-rated	3.31	0.09
Corporate BBB-rated	3.57	0.29
Corporate High-Yield	3.57	1.23
Mortgage-backed Securities-FR	2.53	-1.11
CMBS	1.81	-1.70
ABS	1.86	-0.60

Source: Bloomberg



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INDEX DESCRIPTION

Bloomberg U.S. Universal Index represents the union of the U.S. Aggregate Index, U.S. Corporate High-Yield Index, Investment-Grade 144A Index, Eurodollar Index, U.S. Emerging Markets Index, and the non-ERISA eligible portion of the CMBS Index. The index covers USD-denominated, taxable bonds that are rated either investment-grade or below investment-grade. Some U.S. Universal Index constituents may be eligible for one or more of its contributing subcomponents that are not mutually exclusive. These securities are not double-counted in the index. You can not invest directly in an index.

Bloomberg U.S. Aggregate Bond Index is an unmanaged index that covers the investment grade fixed rate bond market with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. The issues must be rated investment grade, be publicly traded, and meet certain maturity and issue size requirements. You can not invest directly in an index.

Bloomberg U.S. Aggregate Ex-Credit Index (LB Agg (Ex-Credit)) The index covers the U.S. investment grade fixed rate bond market, with index components for government, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis. You can not invest directly in an index.

Bloomberg U.S. Government/Credit Bond Index includes securities in the Government and Credit Indices. The Government Index includes treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government). The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements. You can not invest directly in an index.

Bloomberg U.S. Intermediate Government/Credit Bond Index is the Intermediate component of the U.S. Government/Credit index. The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government). The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements. You can not invest directly in an index.

Bloomberg U.S. 1-3 Year Government Bond Index consist of securities in the U.S. Government Index with a maturity from 1 up to (but not including) 3 years. Securities issued by the U.S. Government (i.e., securities in the Treasury and Agency Indices). Inclusions: Public obligations of the U.S. Treasury with a remaining maturity of one year or more. Publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government. You can not invest directly in an index.

Bloomberg U.S. Treasury Index includes public obligations of the U.S. Treasury. Treasury bills are excluded by the maturity constraint but are part of a separate Short Treasury Index. In addition, certain special issues, such as state and local government series bonds (SLGs), as well as U.S. Treasury TIPS, are excluded. STRIPS are excluded from the index because their inclusion would result in double-counting. Securities in the Index roll up to the U.S. Aggregate, U.S. Universal, and Global Aggregate Indices. You can not invest directly in an index.

Bloomberg U.S. Corporate Bond Index covers USD-denominated, investment-grade, fixed-rate, taxable securities sold by industrial, utility, and financial issuers. It includes publicly issued U.S. corporate debentures and secured notes that meet specific maturity, liquidity, and quality requirements. Securities in the index roll up to the U.S. Credit and U.S. Aggregate indices. The U.S. Corporate Index was launched on January 1, 1973. You

can not invest directly in an index.

ICE BofA 1-Year US Treasury Note Index is comprised of a single issue purchased at the beginning of the month and held for a full month. At the end of the month that issue is sold and rolled into a newly selected issue. The issue selected at each month-end rebalancing is the outstanding Treasury note that matures closest to, but not beyond, one year from the rebalancing date. To qualify for selection, an issue must have settled on or before the month-end rebalancing date. You can not invest directly in an index.

Bloomberg Corporate U.S. High Yield Index - covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (e.g., Argentina, Brazil, Venezuela, etc.) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included. Original issue zeroes, step-up coupon structures, 144-As and pay-in-kind bonds (PIKs, as of October 1, 2009) are also included. The index includes both corporate and non-corporate sectors. The corporate sectors are Industrial, Utility, and Finance, which include both U.S. and non-U.S. corporations. The Yankee sector has been discontinued as of 7/1/00. The bonds in the former Yankee sector have not been removed from the index, but have been reclassified into other sectors. You cannot invest directly in an index.

Bloomberg Global Aggregate Index provides a broad-based measure of the global investment-grade fixed-rate debt markets. The Global Aggregate Index contains three major components: the U.S. Aggregate Index (USD 300 million), the Pan-European Aggregate Index (EUR 300 million), and the Asian-Pacific Aggregate Index (JPY 35 billion). In addition to securities from these three benchmarks (94.4% of the overall Global Aggregate market value), the Global Aggregate Index includes Global Treasury, Eurodollar (USD 300 million), Euro-Yen (JPY 35 billion), Canadian (CAD 300 million), and Investment-Grade 144A (USD 300 million) index-eligible securities not already in the three regional aggregate indices. The Global Aggregate Index family includes a wide range of standard and customized subindices by liquidity constraint, sector, quality, and maturity. The Global Aggregate Index is a component of the Multiverse Index. You can not invest directly in an index.

Bloomberg Global Emerging Markets Index consists of the fixed and floating-rate USD-denominated U.S. Emerging Markets Index and the primarily EUR and GBP-denominated fixed-rate Pan-European Emerging Markets Index and includes emerging markets debt from the following regions: Americas, Europe, Asia, Middle East, and Africa. For the index, an emerging market is defined as any country that has a long term foreign currency debt sovereign rating of Baa1/BBB+/BBB+ or below using the middle rating of Moody's, S&P, and Fitch. The index does not overlap with the U.S. Corporate High-Yield Index or the Pan Euro Corporate High-Yield Index, but may overlap with other investment-grade Aggregate Indices if the securities meet their index eligibility rules. You can not invest directly in an index.

S&P 500 Index – The S&P 500 index includes 500 leading companies in leading industries of the U.S. economy. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe. You can not invest directly in an index.

The NASDAQ-100 Index is a modified capitalization-weighted index of the 100 largest and most active non-financial domestic and international issues listed on the NASDAQ. No security can have more than a 24% weighting. The index was developed with a base value of 125 as of February 1, 1985. Prior to December 21, 1998 the Nasdaq 100 was a cap-weighted index. You can not invest directly in an index.

The Dow Jones Industrial Average (DJIA) is an index used to measure the performance of the U.S. financial markets. Introduced on May 26, 1896 by Charles H. Dow, it is the oldest stock price measure in continuous use. Over the past century "the Dow" has become the most widely recognized stock market indication in the U.S. and probably in the entire world. Most of the stocks included in the index are listed on the New York Stock Exchange, and are all large blue-chip companies that reflect the health of the U.S. economy. All but a handful of these have major business operations throughout the world, thus providing some insight into the economic well-being of the global economy. You can not invest directly in an index.

MSCI EAFE Index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia, and the Far East. You can not invest directly in an index.



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