INVESTMENT COMMENTARY

The first quarter of 2022 could be characterized by the popular meme, "And just like that, all your infectious disease expert friends became geopolitical scholars". Covid-19 pandemic outbreaks continued to weigh on our psyche and the global economy, but the inexplicable Russian invasion of Ukraine took the global center stage. The Federal Reserve noted in the March FOMC statement, "The invasion of Ukraine by Russia is causing tremendous human and economic hardship. The implications for the U.S. economy are highly uncertain, but in the near term the invasion and related events are likely to create additional upward pressure on inflation and weigh on economic activity." U.S. real gross domestic product (GDP) grew at an annualized rate of 6.9% in the fourth quarter of 2021; however, the Conference Board forecasts U.S. Real GDP growth will slow to 1.7% (quarter-over-quarter, annualized rate) in Q1 2022. The Bureau of Labor Statistics (BLS) reported continued declines in the March unemployment rate to 3.6% and U6 unemployment to 7.1%. The Conference Board Consumer Confidence Index was up slightly in March after declines in February and January; the Index now stands at 107.2. Against this backdrop equity markets delivered negative first quarter returns with the S&P500 declining -4.60% and the tech-heavy NASDAQ 100 plunging -8.91%. Interest rates rose and credit spreads widened, as the yield curve flattened in dramatic fashion during the first quarter. The 2-year Treasury yield rocketed upward 161 basis points from 0.73% to 2.34%, while the 10-year Treasury yield climbed 83 basis points to also finish the quarter at 2.34%. The Bloomberg U.S. Aggregate Index generated a negative return (-5.91%), as Treasuries returned -5.58%, yet outperformed all major bond market sectors on a duration adjusted basis. Investment grade (IG) corporate bonds led the bond market lower returning -7.69%, bettered modestly by high yield bonds (-4.84%), U.S. Agency Securities (-5.40%), Mortgage-backed Securities (-4.97%), Commercial MBS (-5.59%) and Asset-backed Securities (-2.88%).

Inflation concerns are weighing heavily on Wall St. and Main St, as inflation measures continue to climb to historic levels. The Consumer Price Index (CPI) rose to 7.91% year-over-year ending February 2022 and the Core PCE Deflator (ex-energy and food) increased to a 30-year high in February to 5.4% year-over-year. The March FOMC statement summarized current risks and thinking as follows, "Indicators of economic activity and employment have continued to strengthen. Job gains have been strong in recent months, and the unemployment rate has declined substantially. Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher energy prices, and broader price pressures". In the March FOMC statement, the Fed announced a 0.25% federal funds rate increase and the anticipation of ongoing rate increases. The Fed further stated their expectation to begin reducing the Federal Reserve balance sheet at a coming meeting. Additionally, the Federal Reserve increased median Fed Fund projections for 2022 to 1.9%, 2023 to 2.8%, and 2024 to 2.8%.

The PIA Investment Strategy Group (ISG) focuses primarily on the direction of the U.S. economy and understanding the outlook for growth and inflation and their impact on interest rates across the yield curve. Prior to the creation of PIA's ISG in 2006, and in fact dating back to the 1990's and the Greenspan era, the Fed's answer to economic and/or financial contractions has been to inject liquidity into the U.S. financial markets. These liquidity injections have come to be reliably known as "Fed Puts" and they've been delivered with minimal risk of economic inflation due to several factors including globalization, automation, lack of wage growth and a decline in labor union participation, plus various regulatory/technical banking factors that ultimately reduced the velocity of money. In fact, we can argue that over the past 30 years the increasingly larger liquidity injections have not produced commensurate economic inflation or growth, but rather asset inflation compounded by persistently low interest rates. So what's different today?

The U.S. was hit by an economic "perfect storm". The global Covid-19 pandemic led to an unprecedented socio-economic paradigm. People were not allowed to move about and most were paid to stay home and/or work from home, while savings rates hit unprecedented levels. Real estate and financial asset prices appreciated substantially, while M2 money supply increased more than $5.25 trillion with our government handing out roughly $6 trillion in relief and stimulus. The Federal Reserve balance sheet has grown from about $900 billion prior to the Global Financial Crisis (GFC) to nearly $9 trillion at the end of 2021. This tsunami of wealth generation and liquidity, coupled with pandemic-related structural disruptions to supply-chain manufacturing and distribution, has brought about unprecedented consumer demand and the resulting pandemic-driven consumption patterns have ultimately produced massive near-term cost inflation. And if this wasn't enough to drive prices higher, the humanitarian crisis in Ukraine only adds to the supply pressures across the commodity complex, specifically with grains, mining and energy. Lastly, we are experiencing what is affectionately being referred to as "The Great Resignation" or "Great Vacation", which increases the leverage of employees. Regardless, for the first time in over 30 years, we're experiencing wage inflation and a potential power/paradigm shift away from corporations back to employees. The U.S. Employment Cost Index indicated wages and salaries for civilian workers climbed 4.5% in 2021, which was the strongest since 1984 according to the BLS. So where do we go from here?

U.S. markets don't have a lot of experience with quantitative tightening (QT), and risk assets didn't respond well the last time the Fed hiked rates in December 2018. In this cycle the Fed has little latitude to walk a very challenging monetary tightrope between soft landing and recession. The market consensus believes employment is abundant and economic growth appears to be strong, but inflation must be reduced and at virtually any cost until under control. The 10-year breakeven inflation rate (FRED) has increased slightly but finished the quarter around 2.86% and has declined since quarter-end. We believe the Fed has some flexibility with actual rate hikes, given the dramatic 1Q22 movement in the 2-year Treasury. While the Fed will need to show their resolve and continue to increase the Fed Funds rate (potentially in increments of 0.50%), the flexibility provided by the dramatically higher short end allows them some time to evaluate the impact of the increase in borrowing costs and higher mortgage rates on the overall economy. We do believe the Fed must also actively reduce their balance sheet, which they have indicated they will do at a more pronounced pace than last time. It is possible, given much of the forecasted Fed Funds increase is nearly priced in, that they could ultimately surprise on the downside if the economy begins to stall in the face of tightening policy and declining demand due to inflation. Monetary policy, specifically QE, was as much or more responsible for this inflation cycle than accommodative interest rates. QT should directly address asset inflation, and it should hopefully keep some steepness in the yield curve by putting some additional upward pressure on long yields. QT will also put less pressure on the housing sector, which is critical to the U.S. economy and has been underbuilt since the 2008 housing hangover.

In the first quarter, PIA portfolio duration remained short relative to our respective benchmarks. We continue to overweight corporate debt, with a focus on high quality credits with strong balance sheets. Our Industrial credits provide incremental risk-adjusted yield and our Financials are senior domestic debt we believe offer attractive compensation for their sector volatility. In our Plus strategies, we maintained our high yield credit exposure as these spreads continue to offer relative value. The Fixed Rate Mortgage-backed Securities sector posted a negative excess return during the 1st quarter, as the Fed continues to reduce their monthly MBS purchases. We maintained our neutral-weight in Agency MBS, as the Fed continues to scale back their asset purchase program with an eye towards adding to the sector, when it offers more attractive risk-adjusted value.

PIA Investment Strategy Group

KEY **RATES**

	3/31/22	12/31/21	12/31/20
Fed Funds Target Rate	**0.25-0.5%**	**0.0-0.25%**	**0.0-0.25%**
3 Month LIBOR	**0.96**	**0.21**	**0.24**
On-the-run Treasuries:			
3 Months	**0.48**	**0.03**	**0.06**
6 Months	**1.01**	**0.18**	**0.08**
2 Years	**2.34**	**0.73**	**0.12**
5 Years	**2.46**	**1.26**	**0.36**
10 Years	**2.34**	**1.51**	**0.91**
30 Years	**2.45**	**1.90**	**1.65**

Source: Bloomberg

KEY **ECONOMIC INDICATORS**

as of	3/31/22	3/31/21
U.S. $ (DXY)	**98.31**	**93.23**
Oil	**100.28**	**59.16**
Gold	**1,937.44**	**1,707.71**
CRB	**295.18**	**184.96**
GDP	**6.9**	**4.3**
CPI	**7.9**	**1.7**
Core (Ex - Food & Energy)	**5.4**	**1.4**
Unemployment Rate	**3.6**	**6.2**
Consumer Confidence	**107.20**	**109.70**
S&P/Case-Shiller – Comp-20	**19.10**	**11.10**

Source: Bloomberg

INDEX **RETURNS**

	1Q'22	YTD	1-Year
Bloomberg –			
Universal	**-6.11%**	**-6.11%**	**-4.23%**
Aggregate	**-5.93**	**-5.93**	**-4.15**
Gov-Credit	**-6.33**	**-6.33**	**-3.85**
Int. Gov-Credit	**-4.51**	**-4.51**	**-4.10**
Corporate	**-7.69**	**-7.69**	**-4.20**
Treasury only	**-5.58**	**-5.58**	**-3.67**
1-3 year Gov	**-2.50**	**-2.50**	**-3.03**
ICE BofA – 1-yr T-Note	**-0.80**	**-0.80**	**-0.94**
High Yield	**-4.84**	**-4.84**	**-0.66**
International Debt	**-6.15**	**-6.15**	**-7.89**
Emerging Markets Debt	**-9.23**	**-9.23**	**-7.51**
S&P 500	**-4.60**	**-4.60**	**15.63**
DJIA	**-4.10**	**-4.10**	**7.11**
NASDAQ 100	**-8.91**	**-8.91**	**14.14**
MSCI EAFE	**-5.77**	**-5.77**	**1.70**

Source: Bloomberg

SECTOR **RETURNS**

1Q'22	Total Return	Excess Return
U.S. Treasuries	**-5.58%**	**0.00%**
Government-related U.S. Agency	**-5.40**	**-0.42**
Government-related Credit	**-5.78**	**-0.41**
Corporate	**-7.69**	**-1.45**
Corporate Financials	**-6.72**	**-1.40**
Corporate Industrials	**-8.03**	**-1.44**
Corporate Utilities	**-8.80**	**-1.68**
Corporate AAA-rated	**-8.95**	**-1.18**
Corporate AA-rated	**-7.86**	**-1.09**
Corporate A-rated	**-7.30**	**-1.22**
Corporate BBB-rated	**-7.94**	**-1.70**
Corporate High-Yield	**-4.84**	**-0.92**
Mortgage-backed Securities-FR	**-4.97**	**-0.71**
CMBS	**-5.59**	**-0.58**
ABS	**-2.88**	**-0.31**

Source: Bloomberg

Pacific Income Advisers is an investment management firm registered with the U.S. Securities and Exchange Commission under the Investment Advisers Act of 1940. PIA manages a variety of fixed income and equity assets for primarily United States clients.

Investing involves the risk of loss, including the loss of principal invested. Past performance is not an indicator of future results.

BENCHMARK 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 February1, 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, Australiasia, and the Far East. You can not invest directly in an index.

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Pacific Income Advisers

1299 Ocean Avenue Second Floor Santa Monica California 90401

telephone 310.255.4488 facsimile 310.434. 0100

www.pacificincome.com