The second quarter of 2022 incurred even greater capital market losses than in the first quarter, leaving investors virtually no safe place to hide. The S&P 500 suffered its worst first-half performance since 1962, while U.S. Treasuries produced their worst first-half results since 1788. Numerous geopolitical risks and ongoing Covid concerns seemed to take a backseat to growing inflation fears and elevated Fed hawkishness. On June 15, the Federal Reserve hiked interest rates by 0.75%, their third rate hike this year and the largest since 1994. Additionally, the Fed announced their plan to reduce its $8.9 trillion balance sheet by allowing monthly run-offs of $30 billion of Treasuries and $17.5 billion of Mortgage-backed Securities. The Fed intends to double these monthly run-off thresholds in September for a combined $95 billion. The Federal Reserve noted in the June FOMC statement, "Overall economic activity appears to have picked up after edging down in the first quarter. Job gains have been robust in recent months, and the unemployment rate has remained low. Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher energy prices, and broader price pressures."

U.S. Real Gross Domestic Product (GDP) shrunk at an annualized rate of -1.6% in the first quarter of 2022. Inflation, as measured by the U.S. Consumer Price Index (CPI), rose to 8.6% in May, the highest year-over-year increase since 1981. The Bureau of Labor Statistics (BLS) reported the unemployment rate held steady the first couple months of the quarter at 3.6%, while the U-6 measure of total unemployed crept up slightly to 7.1%. The Conference Board Consumer Confidence Index decreased in June to 98.7, following a decline in May, to its lowest level since February 2021.

The S&P 500 declined (-16.11%) and the tech-heavy NASDAQ 100 plunged (-22.30%). Interest rates rose and credit spreads widened, as the yield curve steepened slightly during the second quarter. The 2-year Treasury yield increased 61 basis points to 2.95%, while the 10-year Treasury yield increased 67 basis points to finish the quarter at 3.01%. The Bloomberg U.S. Aggregate Index generated another negative return (-4.69%), as Treasuries returned (-3.78%). Investment grade (IG) corporate bonds and High Yield corporate bonds led the bond market lower returning (-7.26%) and (-9.83%), respectively. Other sectors fared better with U.S. Agency Securities (-1.89%), Mortgage-backed Securities (-4.01%), Commercial MBS (-2.85%) and Asset-backed Securities (-0.91%) all posting negative returns.

The PIA Investment Strategy Group (ISG) anticipates the U.S. capital markets are roughly mid-way through this turbulent economic environment caused by the unprecedented and incongruent outgrowth of the pandemic. The ISG Outlook is for an unusually complicated economy through 2022 and into 2023, with significant global concerns. Unfortunately, Covid continues to dampen the global supply-chain recovery, as does China's "zero tolerance" policy. We see no near-term end to the humanitarian crisis in Ukraine, nor resolutions to the resulting grain and energy shortages. Additionally, these aforementioned concerns have exacerbated the resurgence of "on-shoring" and the decline of globalization, arguably the greatest source of disinflation of our generation. While we anticipate a pick-up in unemployment claims in 2022, current job openings remain at historic levels. There are clear signs the pace of growth is slowing and consumer confidence is waning, however consumer balance sheets remain remarkably durable. As the Fed focuses on reducing 40-year high levels of inflation and the erosion of purchasing power, rising interest rates are having a direct impact on household balance sheets as the stock and bond markets have taken historic losses and surging mortgage lending rates have dampened the red-hot housing market. In the first half of 2022, the Fed's year-end Target Rate climbed from 1.9% to 3.4%, and the 2023 Target Rate increased from 2.8% to 3.8%. The Fed's work isn't made any easier by the need for quantitative tightening (QT) to reduce their nearly $9 trillion balance sheet, which we believe was a primary contributor to current levels of inflation. In addition to the massive growth in money supply (M2), Fiscal Policy contributed roughly $6 trillion in relief/stimulus to consumers who were also enjoying ballooning stock market and real estate wealth. Therefore, the Federal Reserve is justifiably focused on reducing inflation, while also minimizing damage to the economy and avoiding a recession. We believe inflation should prove to be in the "peak" vicinity, albeit notably under-reporting import-export price inflation that appears to be in the mid-teens.

Our interest rate outlook now calls for 3-4 additional rate hikes over the next four FOMC meetings in 2022, adding 150 basis points to the current Fed Funds rate.

We anticipate a non-traditional recession over the next twelve months, which should feel less cyclical and more like draining economic excess. We believe there is a greater risk of slow growth with ongoing inflation concerns than a cyclical recession, specifically if the Fed does not follow through on its stated objectives for raising rates and reducing the Fed balance sheet. Our long-term inflation expectations remain at about 3%, above the Fed's stated 2% goal to adjust for a reduction in global disinflationary forces. Therefore, over the next 12 months, we do not anticipate 10-year yields climbing above 4%, and we do anticipate a periodic flat or inverted yield curve. We expect credit spreads to continue to widen out marginally over the coming months, which should create a more attractive opportunity to add a meaningful credit overweight in both investment grade and high yield credit for our Plus strategies.

As interest rates rocketed higher across the curve, PIA modestly reduced our short portfolio duration position to approximately 0.25 years short relative to our Core strategy benchmarks. We continue to slightly 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 that we believe offer attractive compensation for their sector volatility. In our Plus strategies, high yield credit offers relative value, so we continue to look for opportunities to add, given the attractiveness of absolute yields. The Fixed Rate Mortgage-backed Securities sector posted a negative excess return during the second quarter, as the Fed continues to reduce their monthly MBS purchases. We maintained our neutral weight in Agency MBS and continue to monitor the sector, as spreads become more attractive.

PIA Investment Strategy Group

KEY **RATES**

	6/30/22	3/31/22	12/31/21
Fed Funds Target Rate	**1.5-1.75%**	**0.25-0.5%**	**0.0-0.25%**
3 Month LIBOR	**2.29**	**0.96**	**0.21**
On-the-run Treasuries:			
3 Months	**1.63**	**0.48**	**0.03**
6 Months	**2.46**	**1.01**	**0.18**
2 Years	**2.95**	**2.34**	**0.73**
5 Years	**3.04**	**2.46**	**1.26**
10 Years	**3.01**	**2.34**	**1.51**
30 Years	**3.18**	**2.45**	**1.90**

Source: Bloomberg

KEY **ECONOMIC INDICATORS**

as of	6/30/22	6/30/21
U.S. $ (DXY)	**104.69**	**92.44**
Oil	**105.76**	**73.47**
Gold	**1,807.27**	**1,770.11**
CRB	**291.15**	**213.39**
GDP	**-1.6**	**6.4**
CPI	**8.6**	**5.0**
Core (Ex - Food & Energy)	**4.7**	**3.4**
Unemployment Rate	**3.6**	**5.8**
Consumer Confidence	**98.70**	**127.30**
S&P/Case-Shiller – Comp-20	**21.23**	**14.88**

Source: Bloomberg

INDEX **RETURNS**

	2Q'22	YTD	1-Year
Bloomberg –			
Universal	**-5.13%**	**-10.93%**	**-10.89%**
Aggregate	**-4.69**	**-10.35**	**-10.29**
Gov-Credit	**-5.03**	**-11.05**	**-10.85**
Int. Gov-Credit	**-2.37**	**-6.77**	**-7.28**
Corporate	**-7.26**	**-14.39**	**-14.19**
Treasury only	**-3.78**	**-9.14**	**-8.90**
1-3 year Gov	**-0.52**	**-3.01**	**-3.50**
ICE BofA – 1-yr T-Note	**-0.48**	**-1.28**	**-1.44**
High Yield	**-9.83**	**-14.19**	**-12.81**
International Debt	**-11.01**	**-16.49**	**-18.78**
Emerging Markets Debt	**-8.72**	**-17.14**	**-18.02**
S&P 500	**-16.11**	**-19.97**	**-10.64**
DJIA	**-10.78**	**-14.44**	**-9.05**
NASDAQ 100	**-22.30**	**-29.22**	**-20.38**
MSCI EAFE	**-14.32**	**-19.23**	**-17.26**

Source: Bloomberg

SECTOR **RETURNS**

2Q'22	Total Return	Excess Return
U.S. Treasuries	**-3.78%**	**0.00%**
Government-related U.S. Agency	**-3.99**	**-0.67**
Government-related Credit	**-4.69**	**-0.86**
Corporate	**-7.26**	**-2.24**
Corporate Financials	**-5.72**	**-2.22**
Corporate Industrials	**-7.91**	**-2.29**
Corporate Utilities	**-8.52**	**-1.98**
Corporate AAA-rated	**-8.22**	**-0.48**
Corporate AA-rated	**-7.32**	**-1.12**
Corporate A-rated	**-6.56**	**-1.74**
Corporate BBB-rated	**-7.80**	**-2.87**
Corporate High-Yield	**-9.83**	**-7.92**
Mortgage-backed Securities-FR	**-4.01**	**-0.98**
CMBS	**-2.85**	**-0.36**
ABS	**-0.91**	**-0.11**

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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