Monthly Market Review

MINNESOTA SCHOOL DISTRICT LIQUID ASSET FUND PLUS

Information provided by MSDLAF+'s Investment Adviser PFM Asset Management LLC

"Mixed signals or solid recovery? Something doesn't quite add up."

Economic Highlights

- Stocks continued their historic rebound, labor markets improved, the housing market expanded and bonds began to price in rising inflation expectations. But, simultaneously, the risk of a "K-shaped" recovery grew as the coronavirus threat, protests over the racial divide and widening gaps in income and wealth challenged the way forward.
- The Federal Open Market Committee announced major policy shifts on inflation and employment in August. The Federal Reserve (Fed) will now seek "to achieve inflation that averages 2% over time," moving away from the prior point-in-time target approach. Since inflation has run below 2% for some time, this implies that the Fed would let inflation run higher for a time before raising rates as it seeks to promote stable rising prices and recovery to maximum employment. Fed governors are also quite vocal in calling for more fiscal stimulus to supplement its zero-rate monetary policy.
- The U.S. economy added 1.4 million jobs in August, and the headline unemployment rate fell to 8.4% (from 10.2% in July). This was a robust result, but one that nevertheless signaled a slowing pace of recovery. Government employment increased due to temporary census workers, with other notable gains in retail, business services, leisure and hospitality, and education and health services. Yet total employment remains more than 11 million below February's pre-pandemic level.
- Manufacturing activity expanded at the fastest pace since late 2018. New orders jumped to the highest point since the start of 2004 and, along with declining inventories, should continue to support production.
- Consumers increased spending in July, albeit at a slower pace than in prior months, as COVID-19 concerns linger and the expiration of government aid programs loom. One worrisome sign is that consumer confidence fell to a new pandemic low, another is that business investment remains weak.

Bond Markets

- The U.S. Treasury yield curve steepened as Treasury debt issuance weighed on the markets and the new Fed policy suggested if price increases take hold, the central bank would refrain from what some might view as precipitous action to dampen inflation. The front end of the yield curve remained relatively unchanged, with yields maintaining a low and tight range. Meanwhile, maturities beyond seven years increased 18 to 28 basis points (bps) (0.18% to 0.28%).
- As a result, longer-maturity Treasuries underperformed; returns on shorter tenors were muted. For August, the 3-month Treasury Index returned 0.01%; the 5-year Treasury Index returned -0.22% and the 10-year Treasury Index returned -1.33%.
- Investment-grade (IG) corporate bonds out-performed once again, even though issuance heated up again in August. IG corporate spreads continued to grind tighter, nearing pre-pandemic levels.
- For the month, IG companies raised $144 billion of debt compared to $70 billion issued in July.

Equity Markets

- U.S. equities reached new highs with the S&P 500 rising 7.0%, pushing year-to-date (YTD) performance to 8.3%. This growth has been largely driven by large-company stocks in the technology, consumer discretionary and telecommunication sectors. The NASDAQ soared 9.6%, lifting YTD performance to 31.2%. The Dow returned 7.6%, albeit leaving YTD performance down 0.4%. The divergence of the Dow alludes to the challenges that still face the large bulk of the industrial sector and the narrow base for the stock market recovery.
- Global developed market equities (as measured by the MSCI ACWI-Ex-U.S. Index) rose 4.28%, a solid result but one that trailed the U.S.
- The U.S. Dollar Index (DXY) weakened, falling over 10% from its March highs.

PFM Strategy Recap

- A slowing recovery, stable rates and a flat yield curve are reasons for us to maintain a neutral duration strategy.
- We continued to add federal agency securities at attractive yields, especially for maturities three years and longer. In some cases, agency yields were comparable to those on high-quality corporate issues.
- IG corporate yield spreads have now receded to near pre-pandemic levels. As a result, the sector has been a boon for portfolio performance. Nevertheless, economic uncertainty clouds corporate outlooks, even amid unprecedented Fed support. Prompted by tight spreads, and expectations for a drawn-out recovery, we are implementing a modestly defensive bias in the sector.
- Spreads on AAA-rated asset-backed securities (ABS) also moved tighter, to near pre-COVID-19 levels. We are maintaining allocations in the sector, and focusing on tranches with increased credit enhancements.
- We have trimmed allocations in the mortgage-backed securities (MBS) sector, awaiting better fundamentals.
- The taxable municipal sector continued to offer value. Though credit stresses may emerge in the state and local government sector large state-level and essential services issuers were attractive.

U.S. Treasury Yields

Duration	Aug 31, 2019	Jul 31, 2020	Aug 31, 2020	Monthly Change
3-Month	1.98%	0.09%	0.10%	0.01%
6-Month	1.87%	0.10%	0.11%	0.01%
2-Year	1.51%	0.11%	0.13%	0.02%
5-Year	1.39%	0.21%	0.27%	0.06%
10-Year	1.50%	0.53%	0.71%	0.18%
30-Year	1.96%	1.19%	1.48%	0.29%

Yields by Sector and Maturity as of August 31, 2020

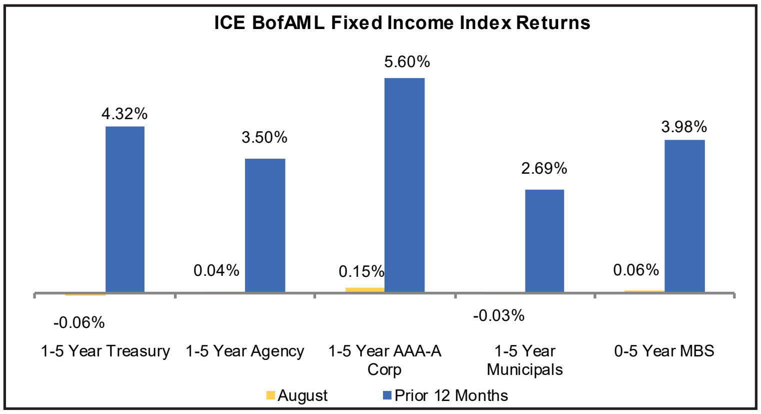
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	0.10%	0.08%	0.16%	--
6-Month	0.11%	0.08%	0.23%	--
2-Year	0.13%	0.18%	0.33%	0.25%
5-Year	0.27%	0.43%	0.74%	0.51%
10-Year	0.71%	1.05%	1.59%	1.10%
30-Year	1.48%	1.69%	2.74%	1.72%

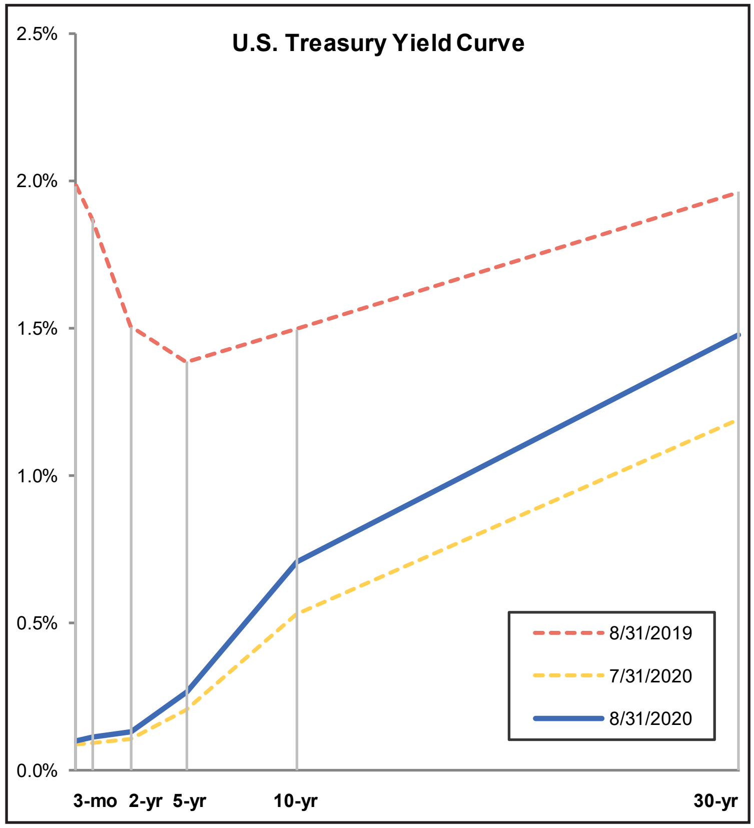
Spot Prices and Benchmark Rates

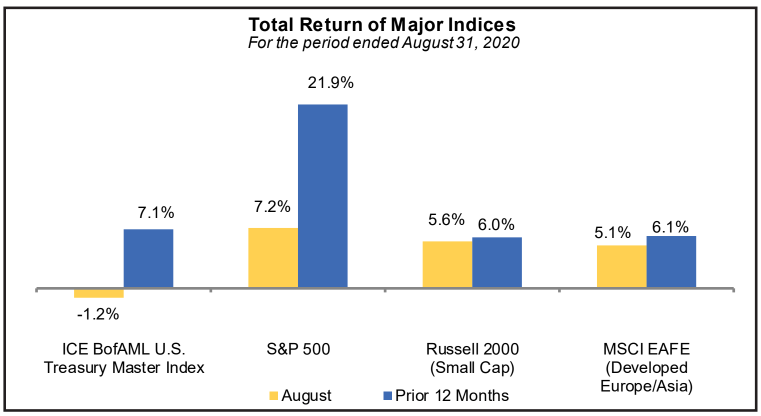
Index	Aug 31, 2019	Jul 31, 2020	Aug 31, 2020	Monthly Change
1-Month LIBOR	2.09%	0.15%	0.16%	0.01%
3-Month LIBOR	2.14%	0.25%	0.24%	-0.01%
Effective Fed Funds Rate	2.13%	0.10%	0.09%	-0.01%
Fed Funds Target Rate	2.25%	0.25%	0.25%	0.00%
Gold ($/oz)	$1,523	$1,963	$1,971	$8
Crude Oil ($/Barrel)	$55.10	$40.27	$42.61	$2.34
U.S. Dollars per Euro	$1.10	$1.18	$1.19	$0.01

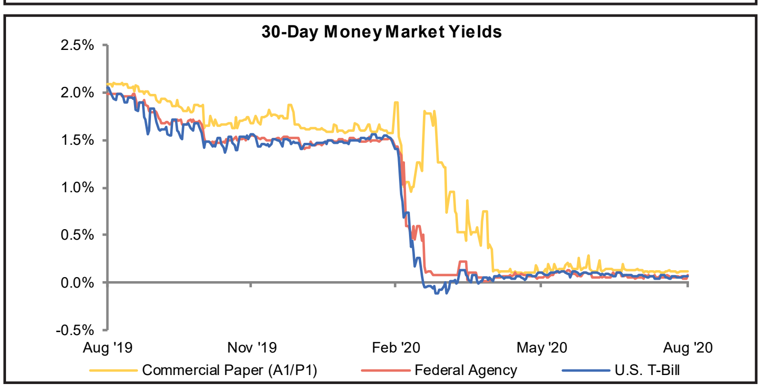
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Consumer Confidence	21-Aug	Jul	24.7%	14.6%
GDP Annualized QoQ	25-Aug	Aug	84.8	93.0
PCE Core Deflator YoY	27-Aug	2Q S	-31.7%	-32.5%
ISM Manufacturing	28-Aug	Jul	1.3%	1.2%
Continuing Claims	1-Sep	Aug	56.0	54.8
Unemployment Rate	3-Sep	Aug 22	13,254k	14,000k
Retail Sales MoM	4-Sep	Aug	8.4%	9.8%









Source: Bloomberg. Data as of August 31, 2020, unless otherwise noted.

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