



JOSEPH ABRUZZO
CLERK OF THE CIRCUIT COURT & COMPTROLLER
PALM BEACH COUNTY

Florida Local Government Investment Trust "Financial Fridays"

- Managing Bonds When the FED is Raising Rates

By John Burford,
Clerk of the Circuit Court & Comptroller,
Palm Beach County
August 12, 2022

The Bottom Line:

Economy slows but grows

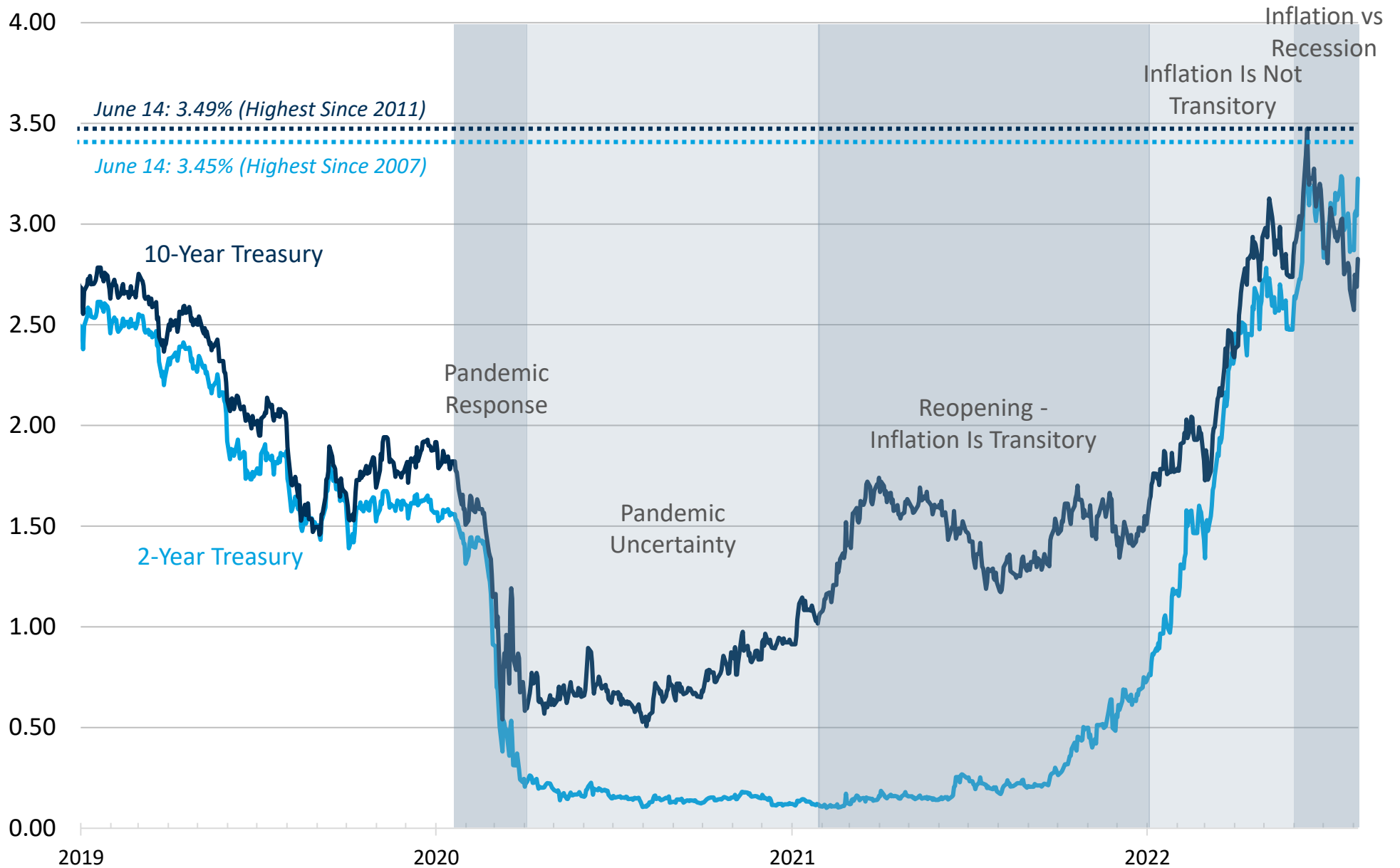
Full employment

High inflation

FED raising interest rates

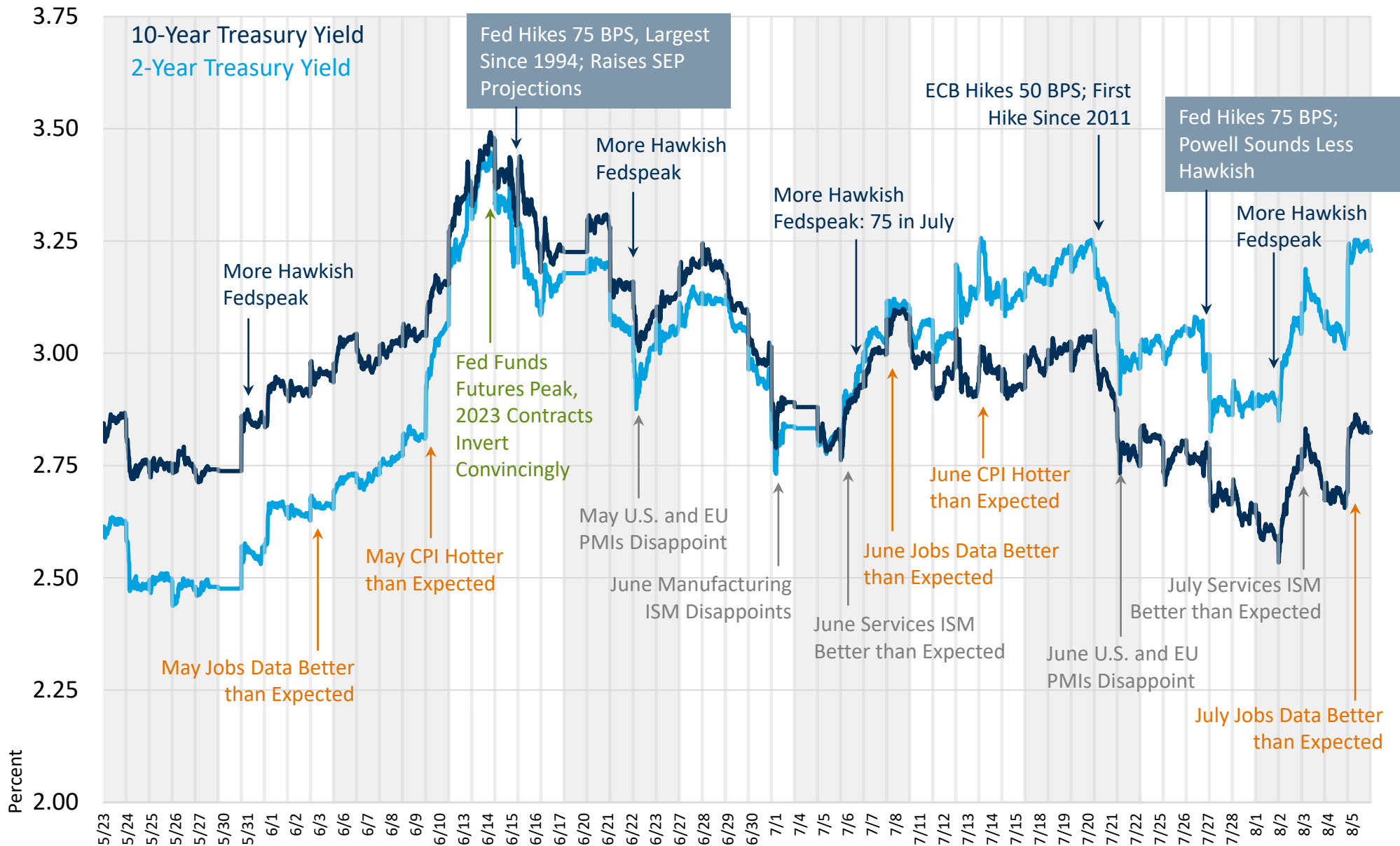


Rate Cycle Moves into New Territory: Weighing the Risk of Recession Against the Durability of Inflation



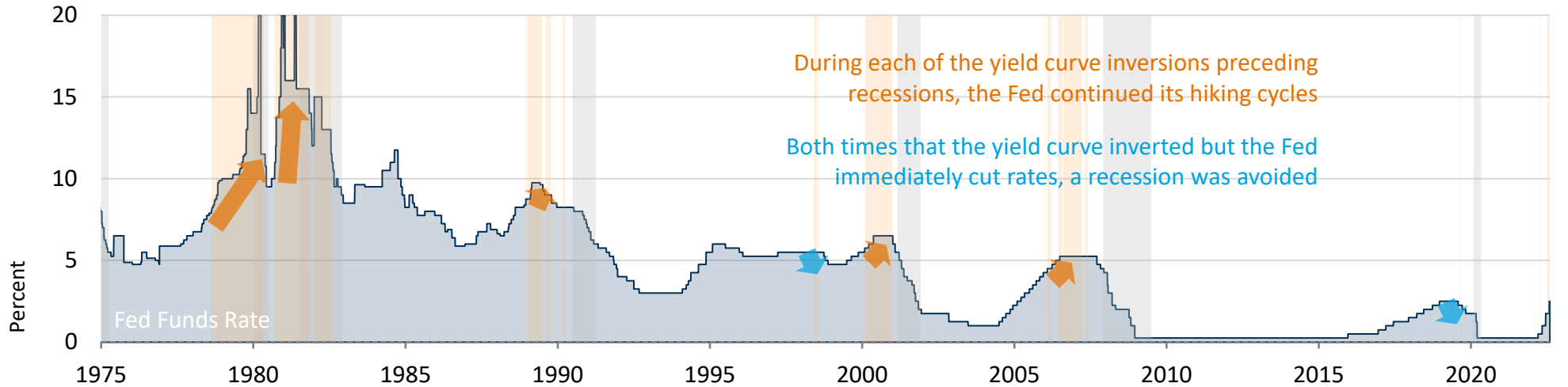
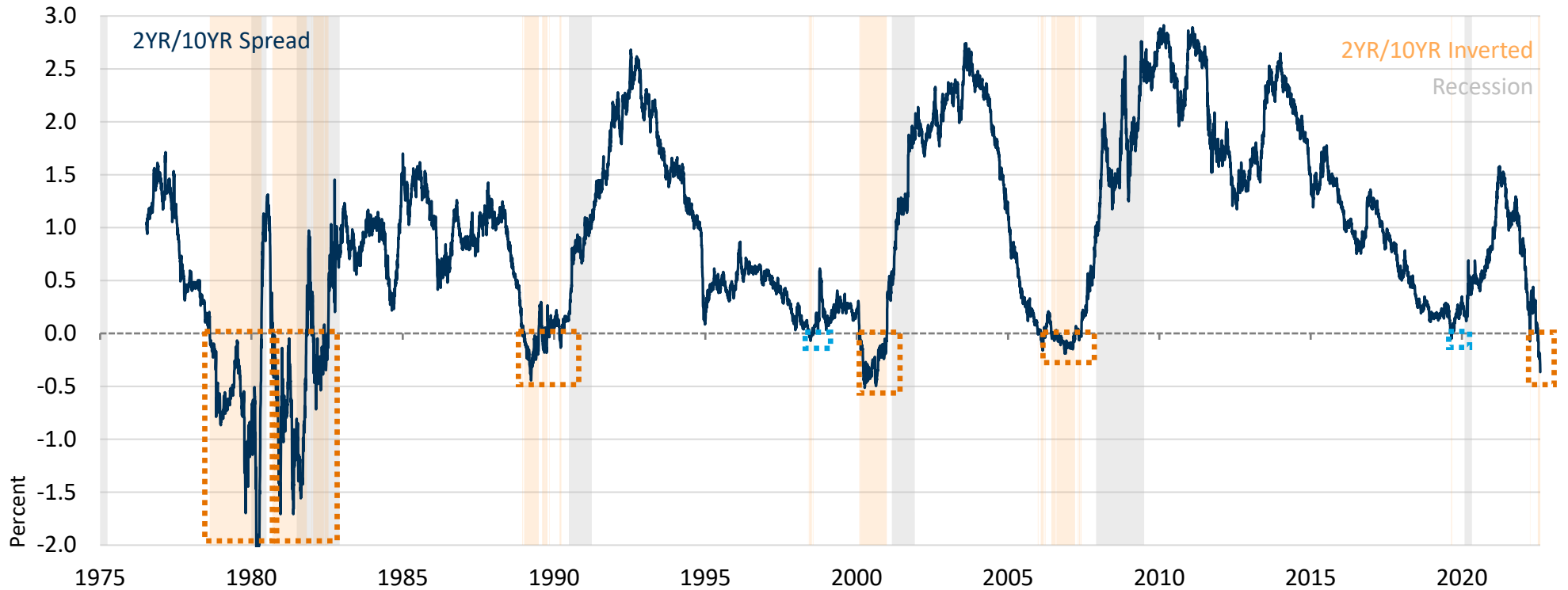
Treasury Yields | 10-Year Pivots While 2-Year Grinds Higher

Curve Inverts on Rising Inflation, Strong Labor Reports, Hawkish Fed Response, and Recession Fears



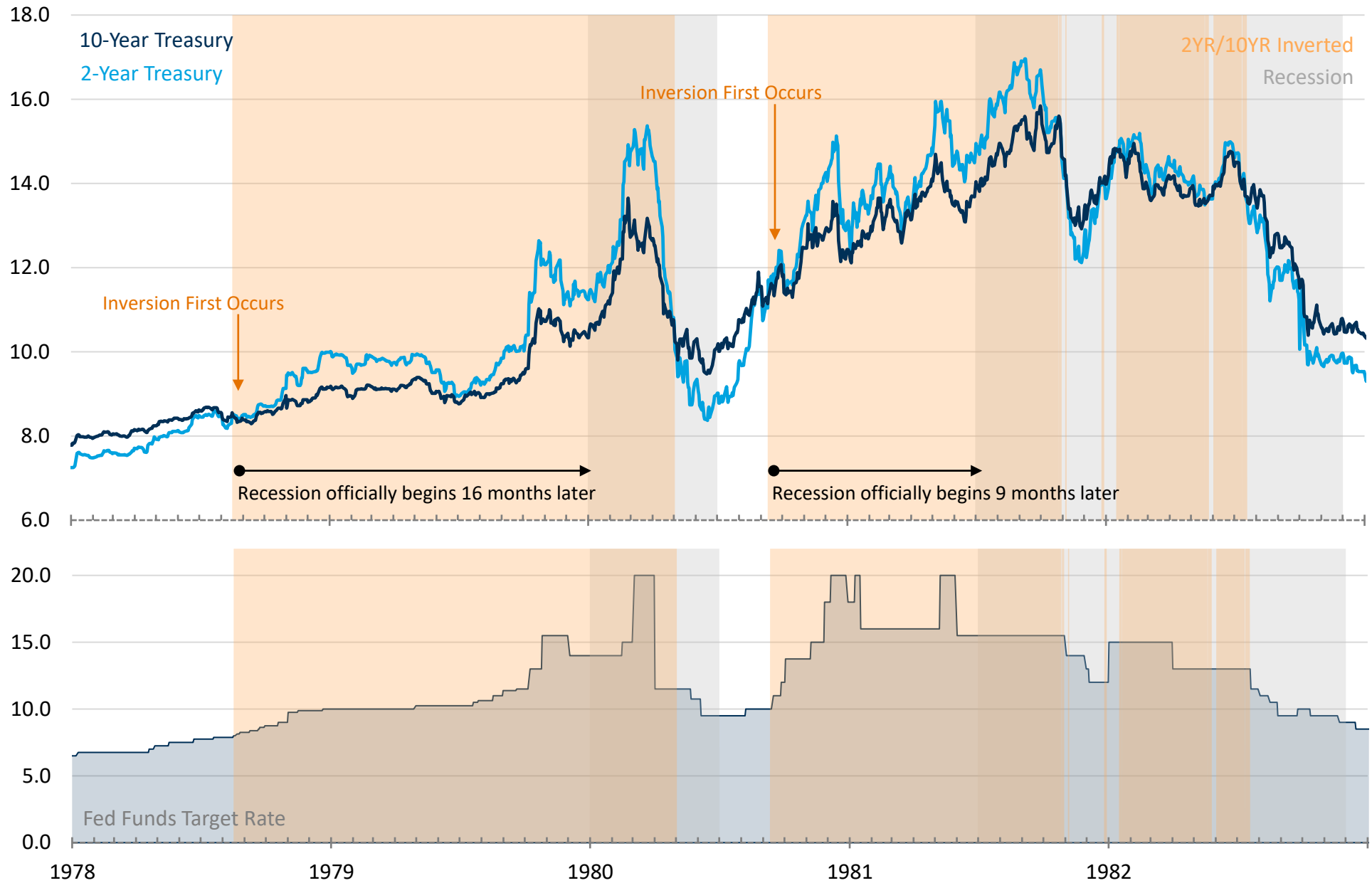
Treasury Yields | Yield Curve Rapidly Inverts to Deepest Inversion Since 2000

2YR/10YR Spread (Percentage Points)



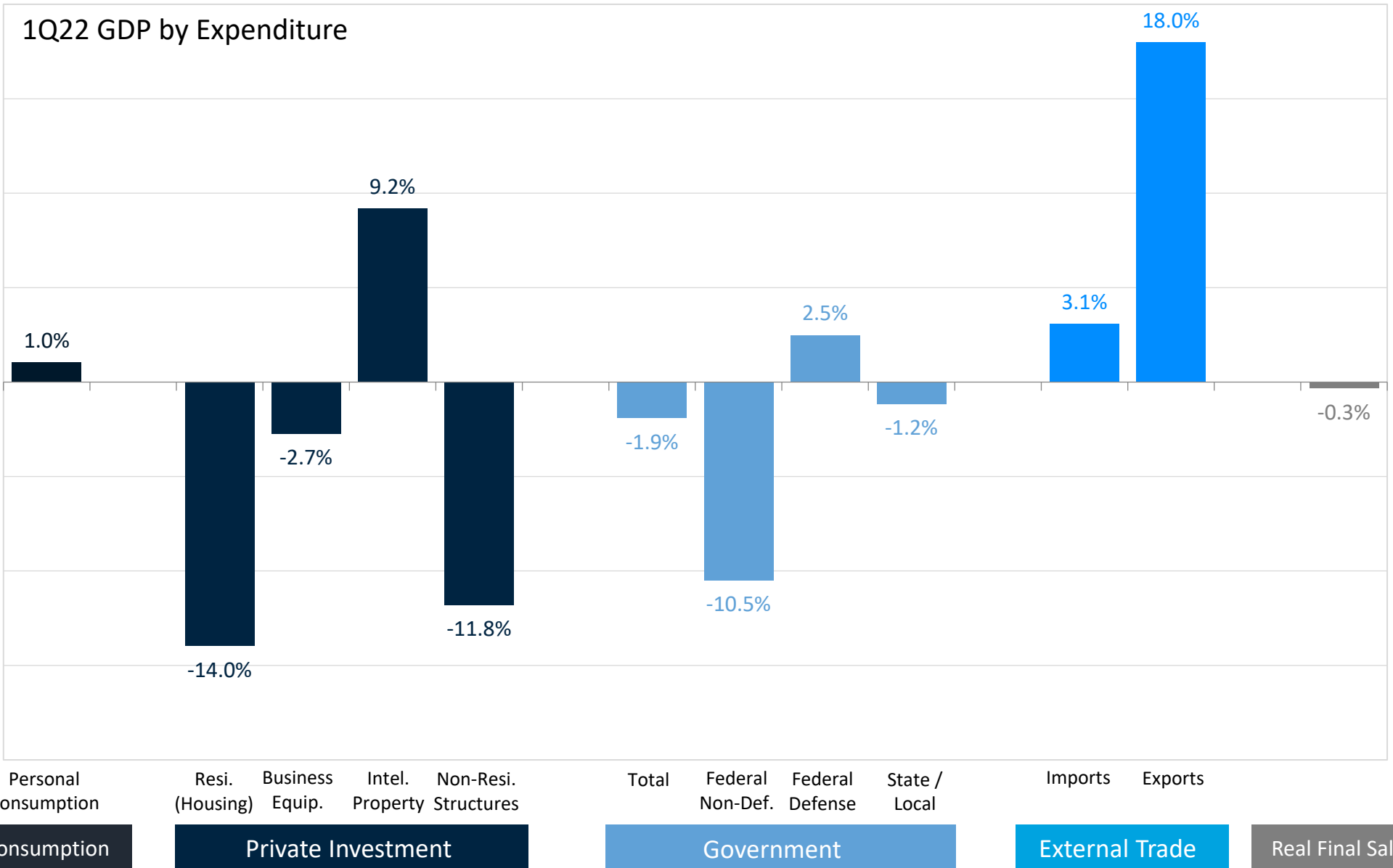
Treasury Trends During Interest Rate Cycles | 1978-1982 Cycles

2-Year Treasury, 10-Year Treasury, and Fed Funds

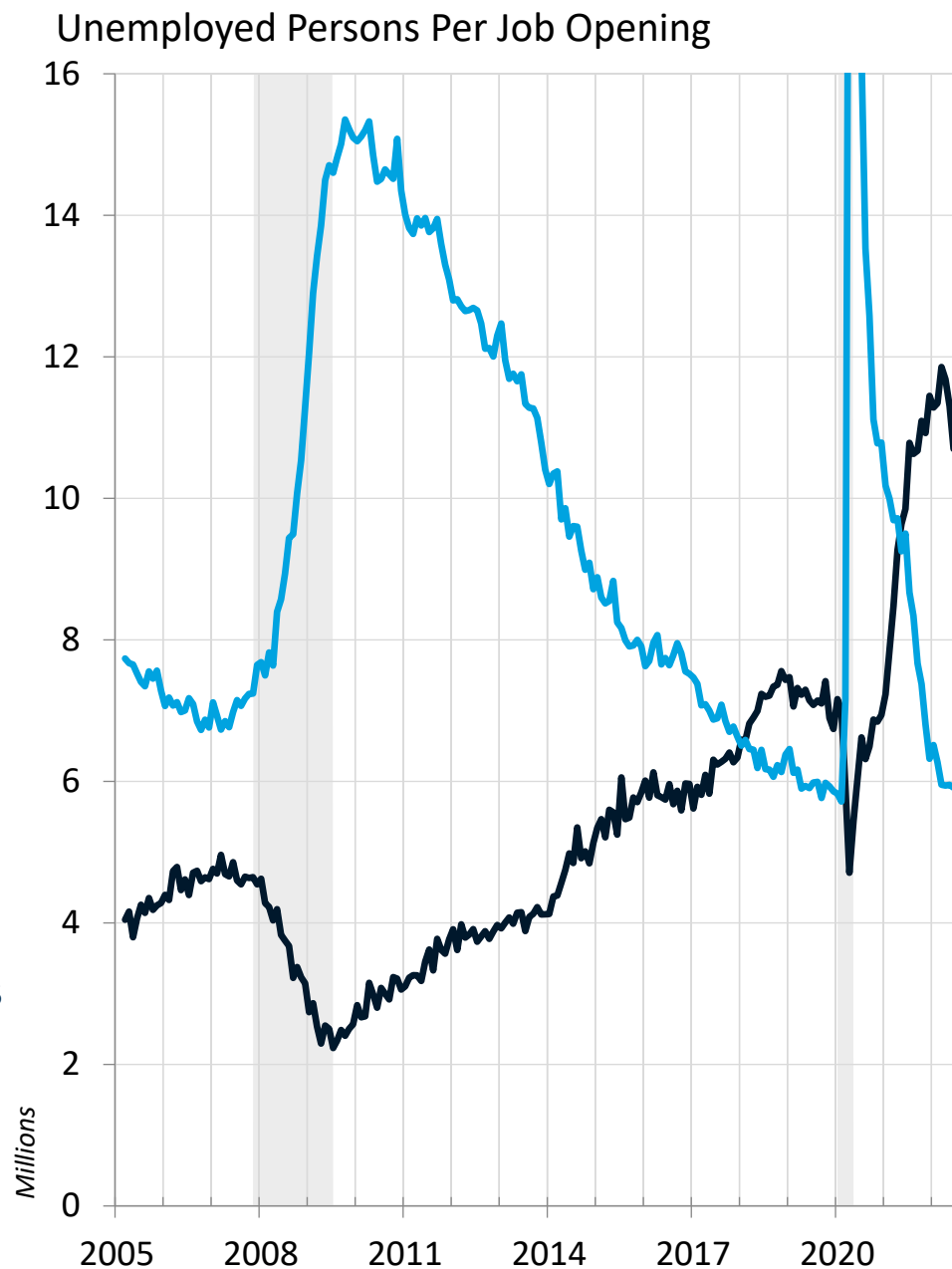
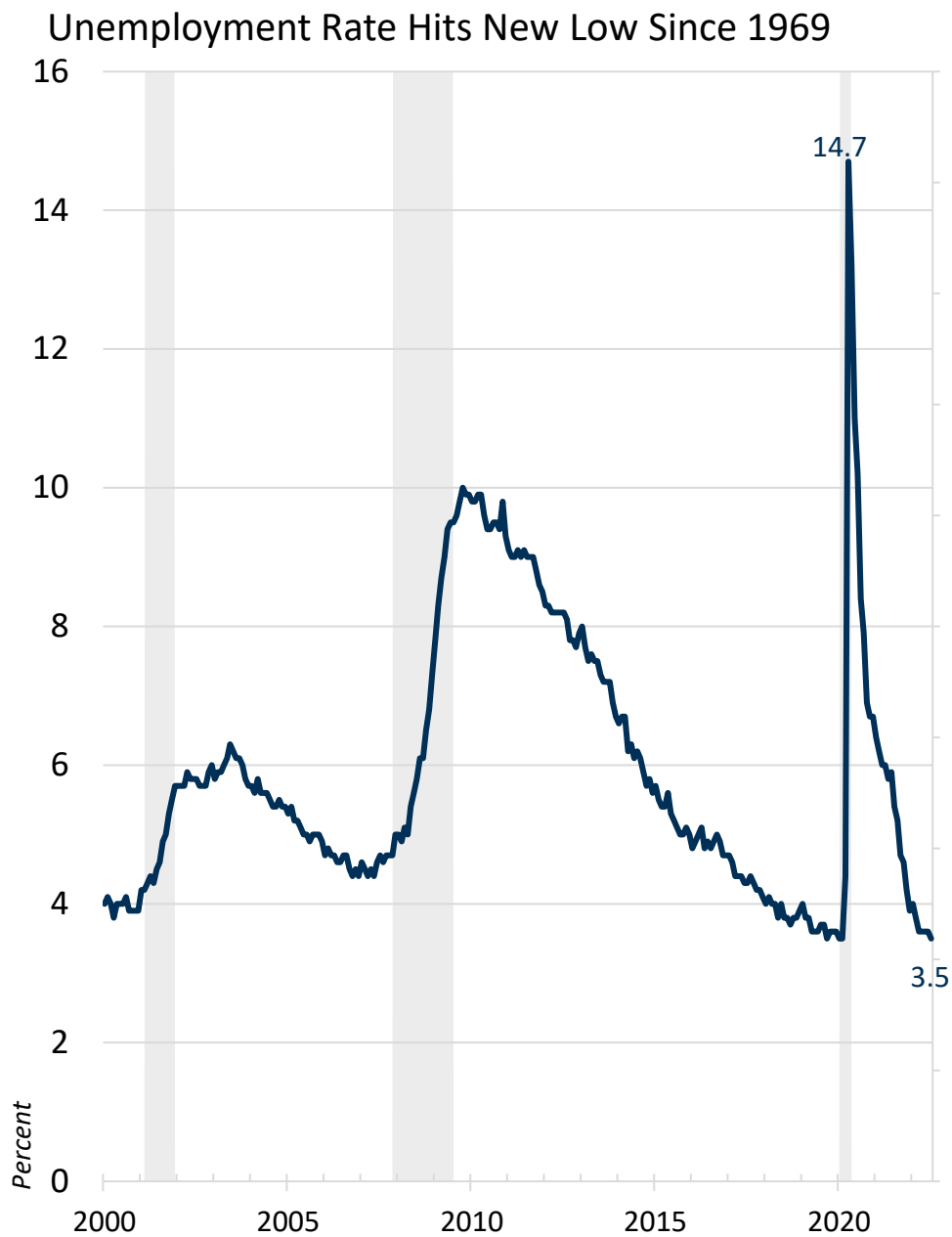


GDP by Expenditure

Economy Contracts 0.9% in 2Q22 | Spending Slows, Inflation Bites | Real Final Sales ▼ 0.3%

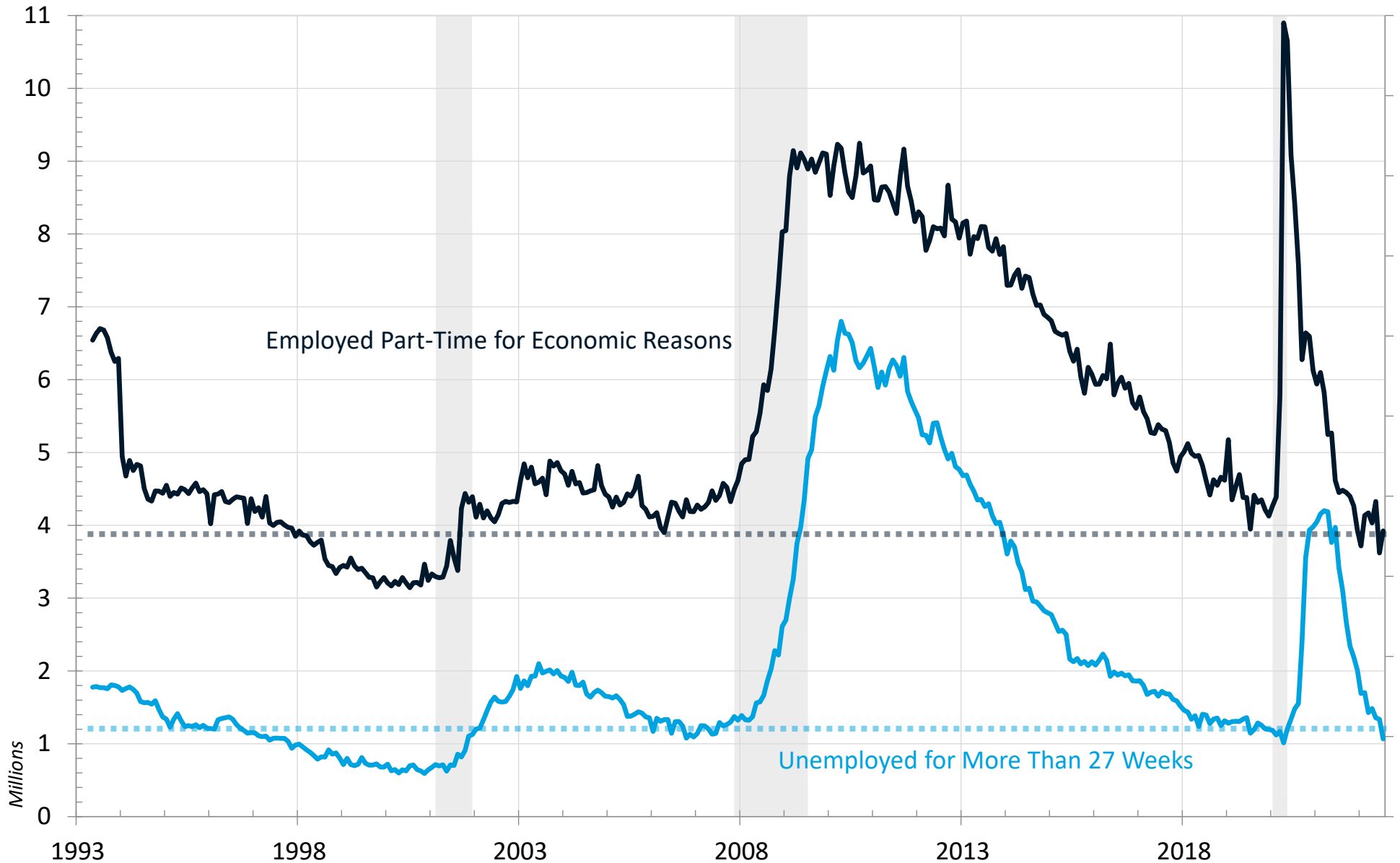


Shortage of Labor Supply Biggest Challenge for Labor Market Post-Pandemic



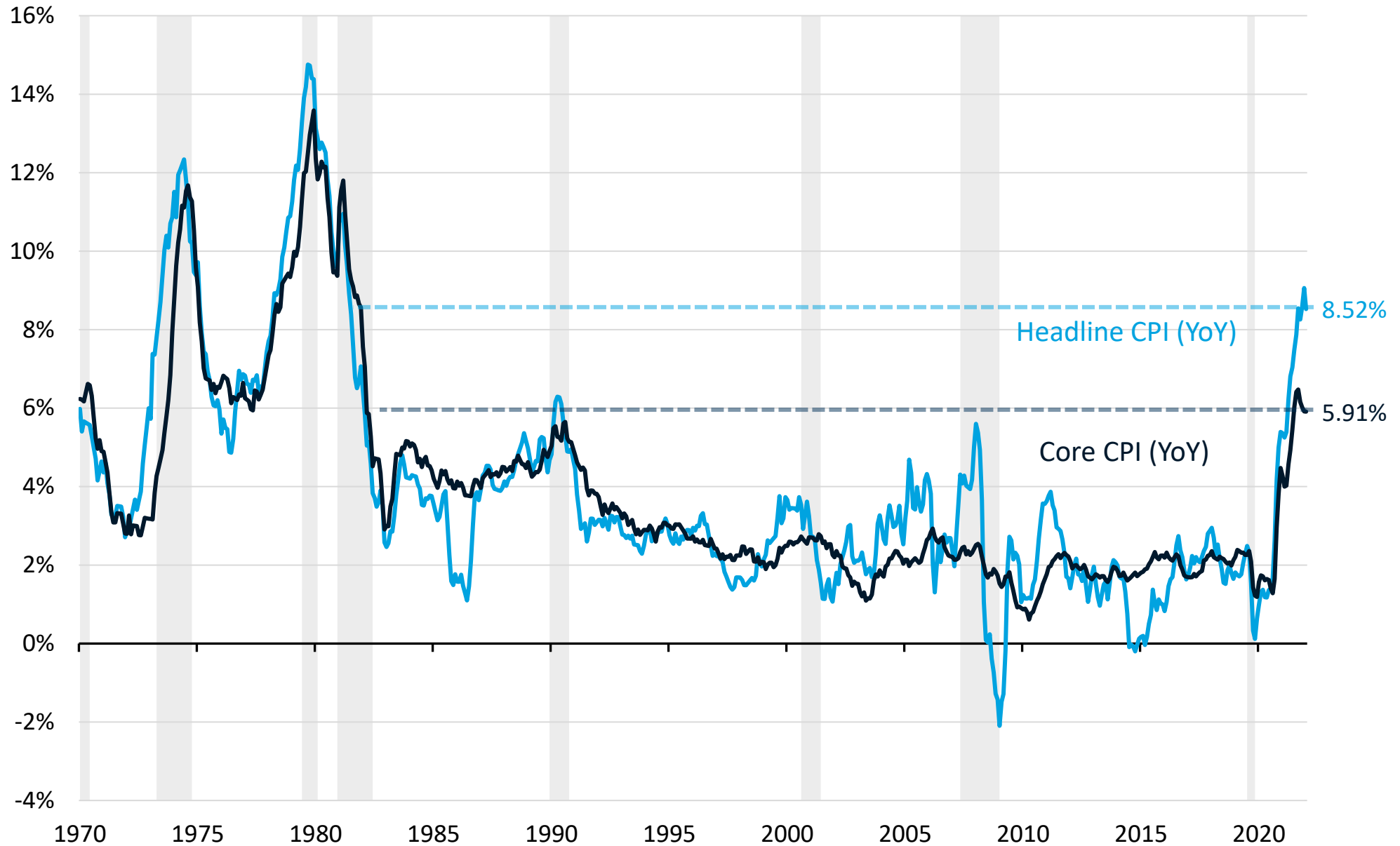
Majority of Pandemic Damage to Labor Market Resolved

Measures of Underemployment and Long-Term Unemployed at Historically Low Levels



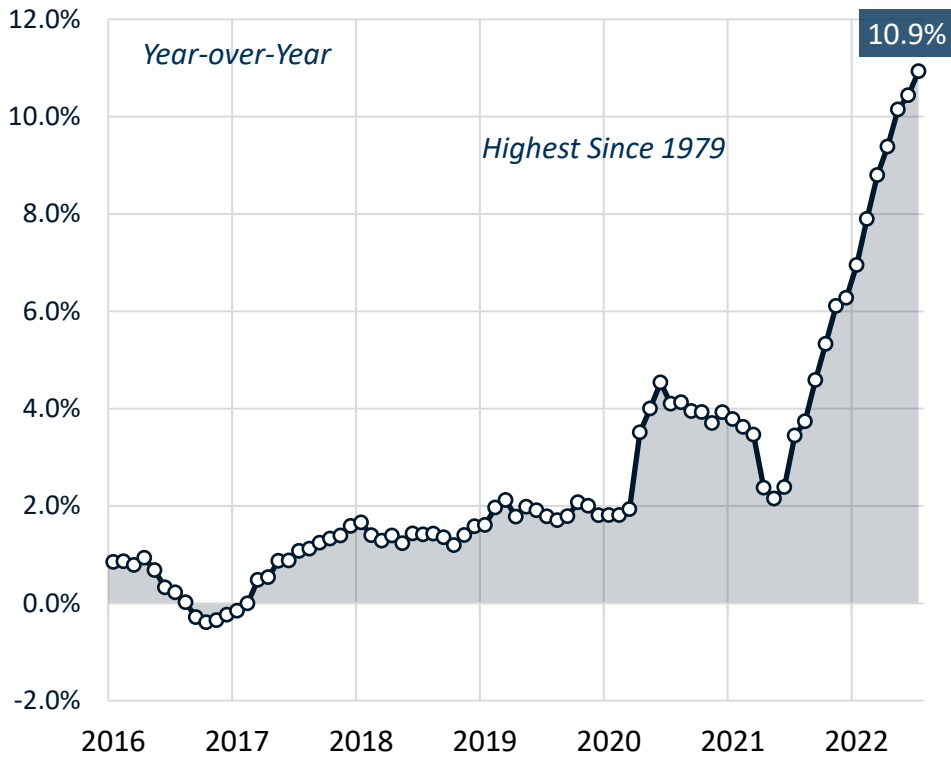
Headline CPI Slows from Fastest Rate Since 1981 in July Relief

Headline and Core CPI (Year-over-Year)

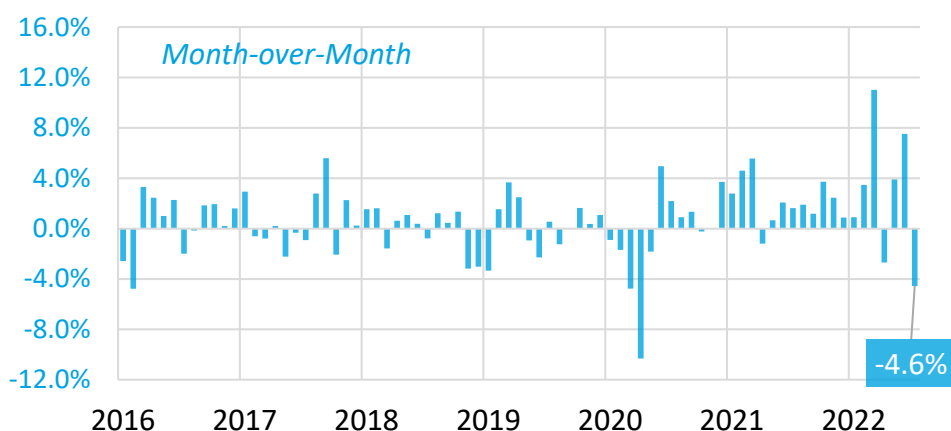
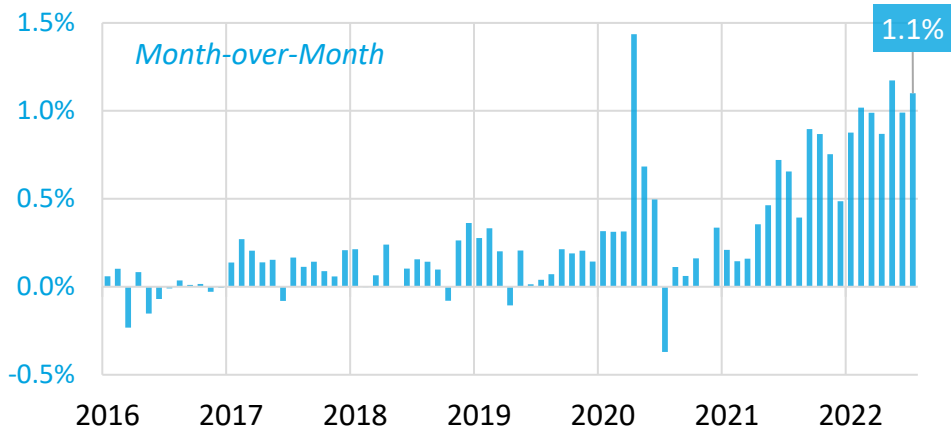
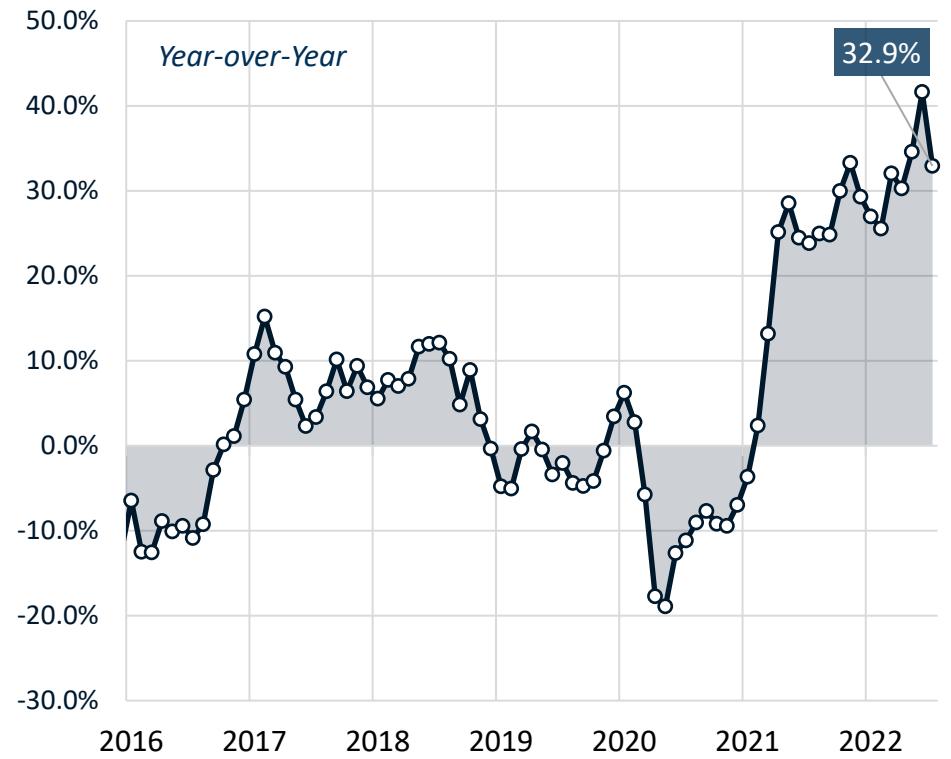


Food Prices Continue to Climb | Energy Prices Finally Cool | YoY Rates Remain High

Food CPI

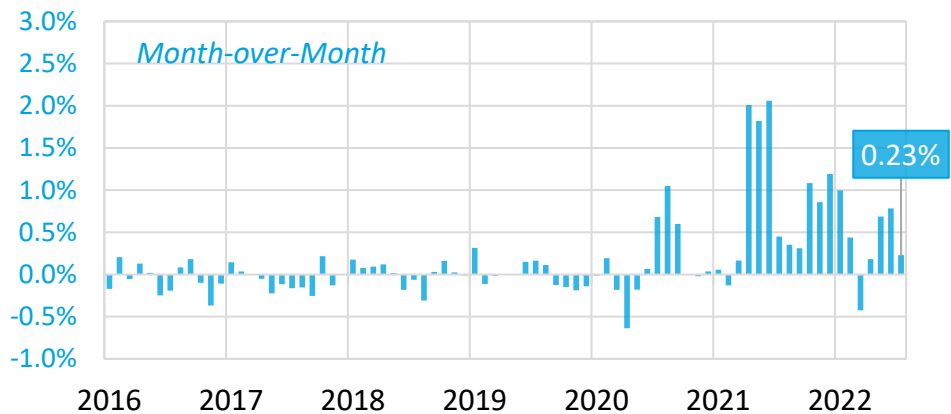
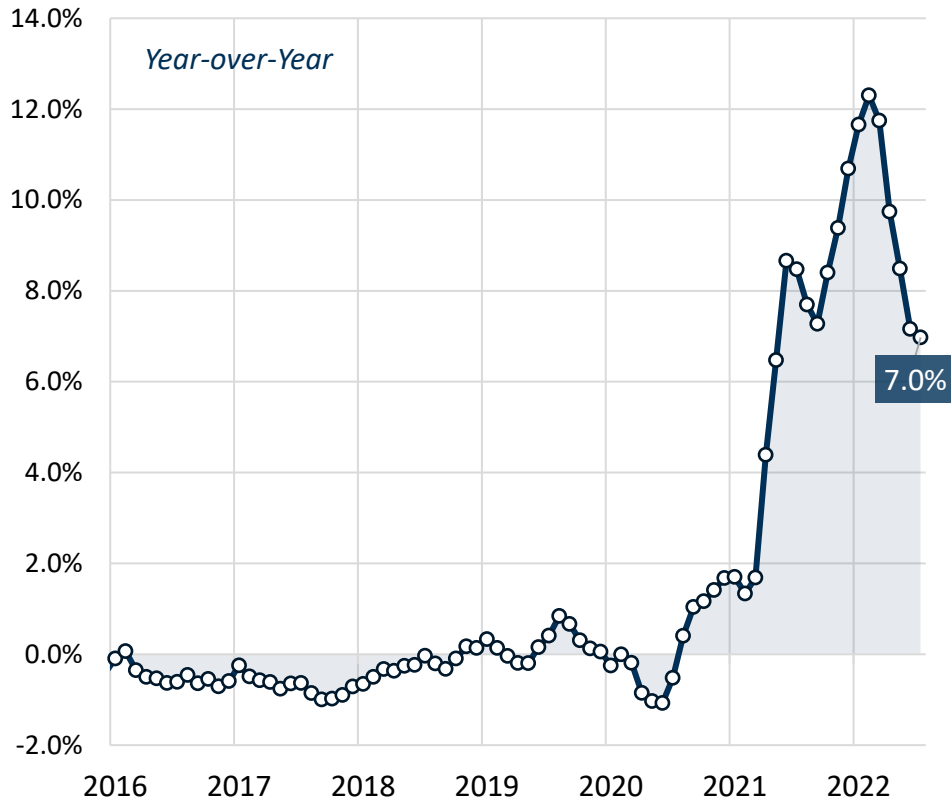


Energy CPI

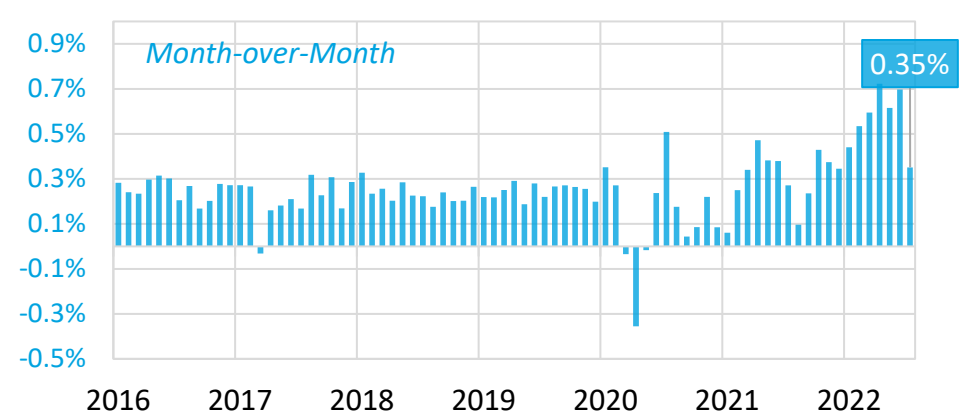
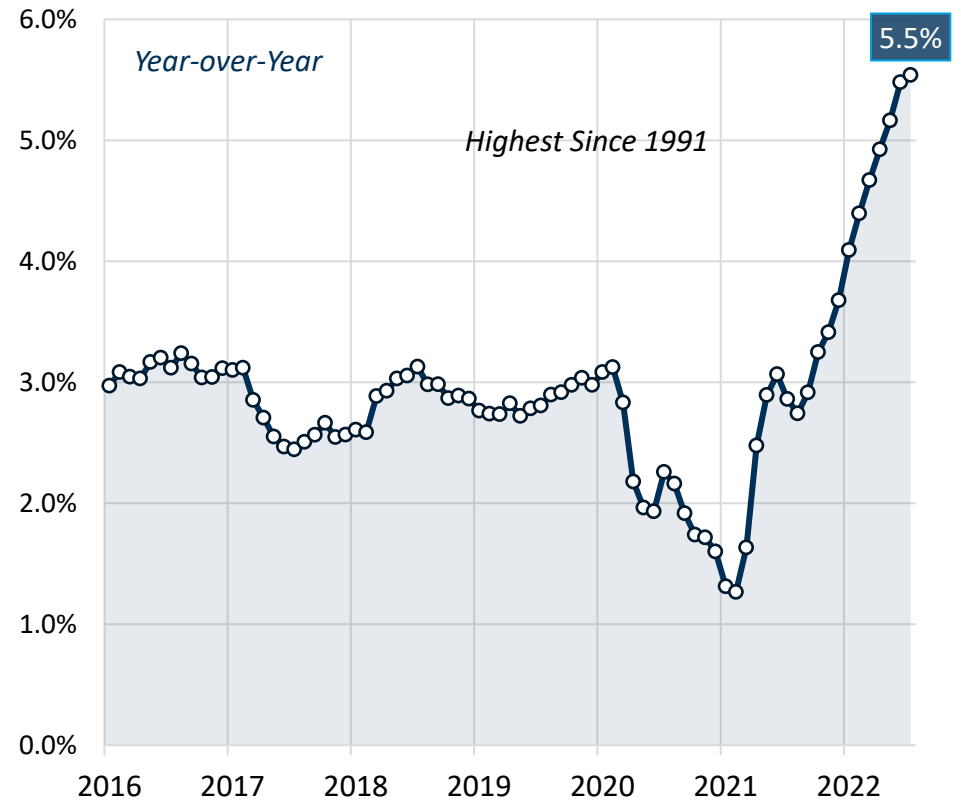


Core Components Show First Signs of Relief in July Report | Positive, But Still Inconclusive

Core Goods CPI

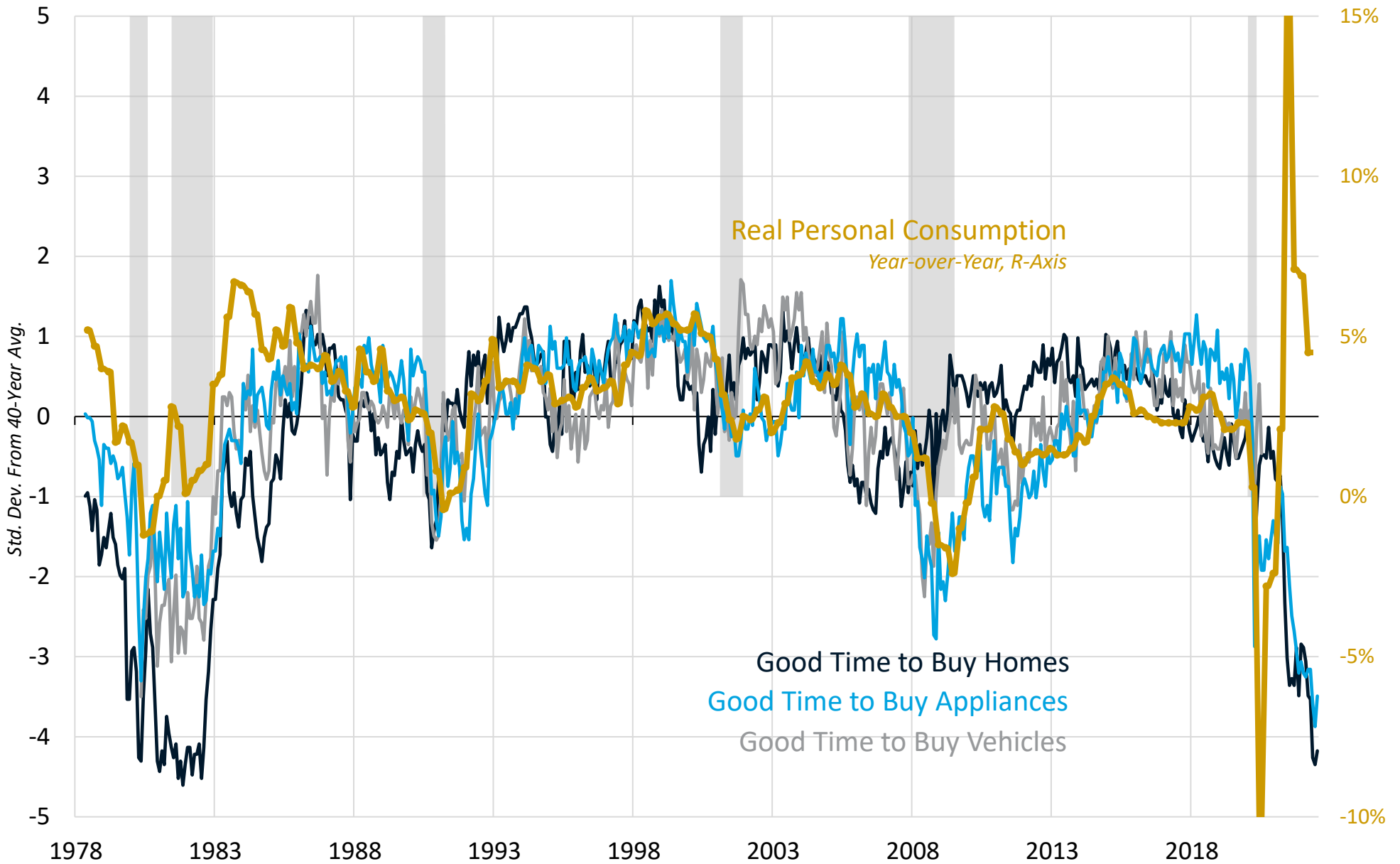


Core Services CPI



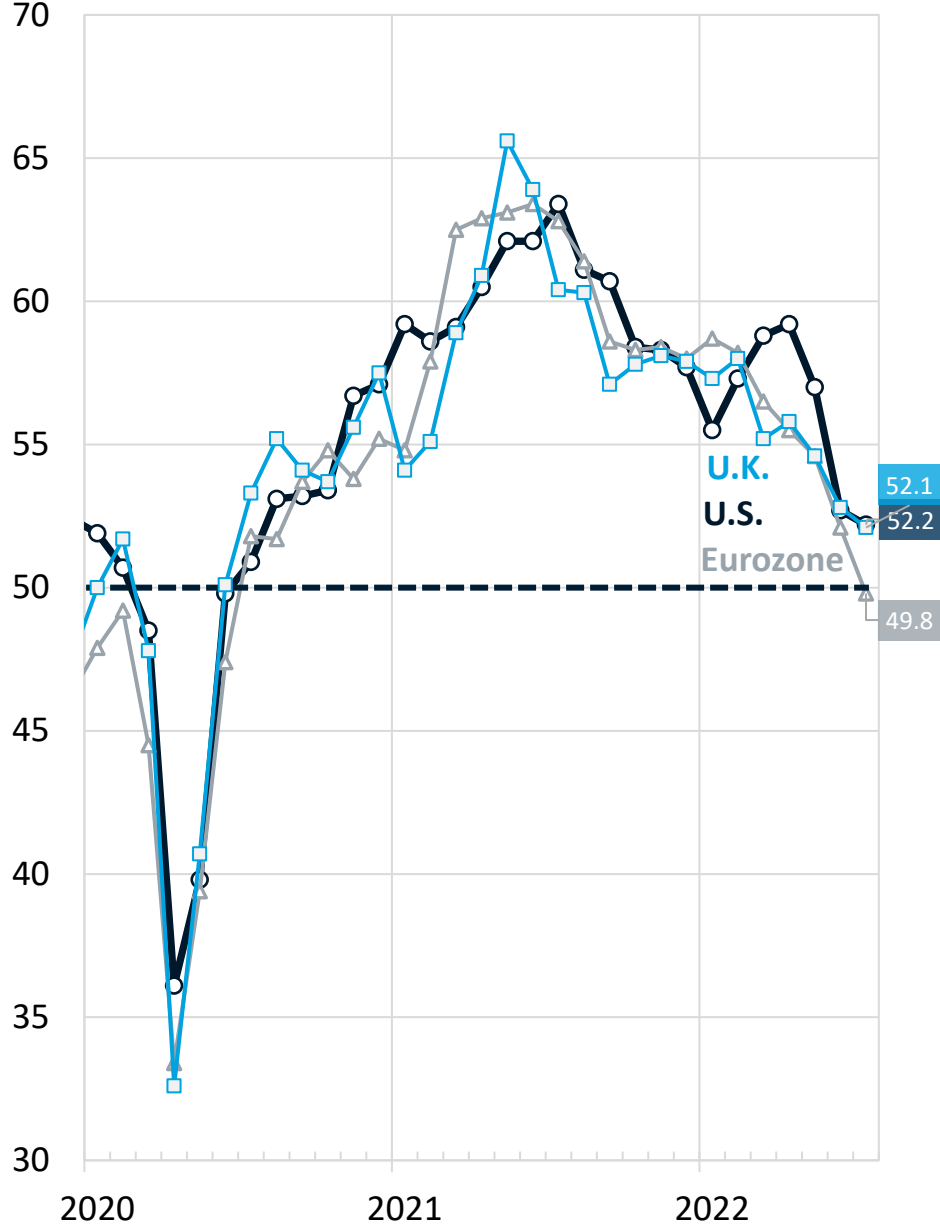
Inflation's Impact: Consumer Psyche

Consumer Confidence Regarding Buying Conditions for Big-Ticket Items

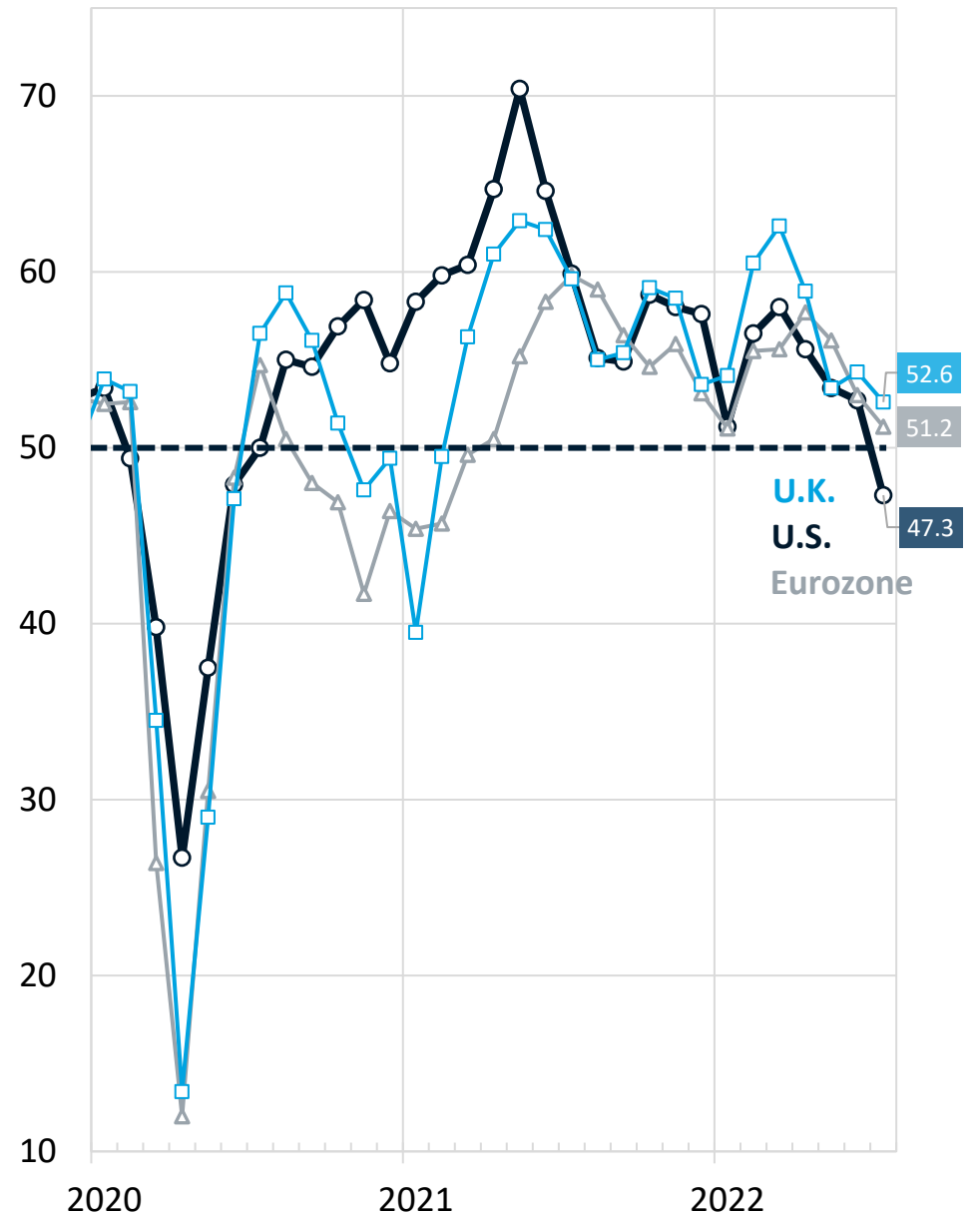


Inflation's Impact: Exacerbated by Global Conflict, Inflation Weighing on Economic Activity

S&P Global Manufacturing PMIs

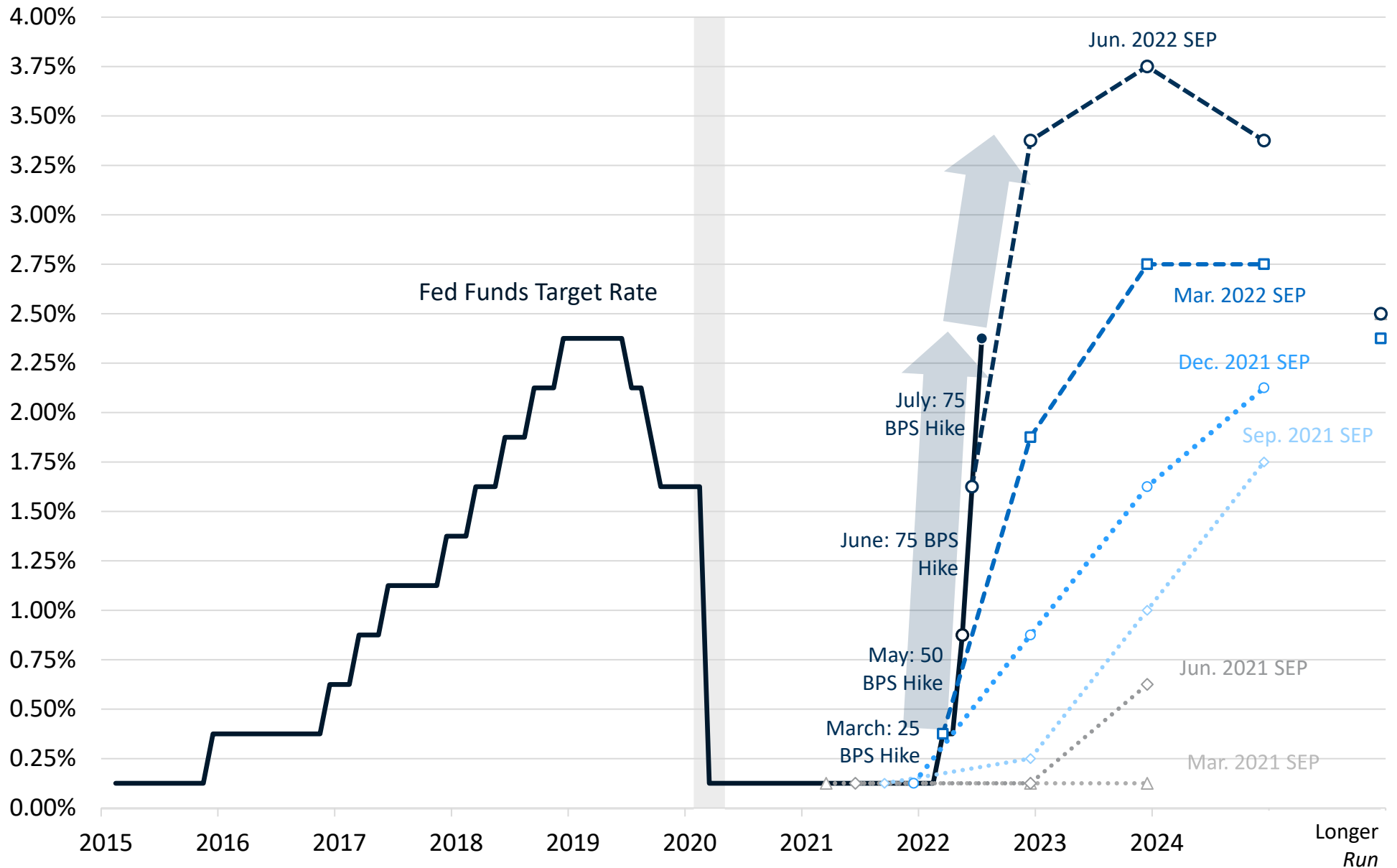


S&P Global Services PMIs



Inflation's Impact | Fed Hikes 225 Basis Points in 4 Months, Fastest Liftoff in 40 Years

Fed Funds Rate and FOMC Median Projections (by Meeting)



Economic Data Soften but Fed Remains Focused on Inflation

Federal Open Market Committee – July 2022 Meeting

Overnight Target Rate: +75 bps to 2.25% - 2.50% (Matching Largest Hike Since 1994)

IOER Rate: +75 bps to 2.40%

Balance Sheet: Balance Sheet Reduction Continues at \$47.5b per Month through September

Official Statement – Officials Acknowledge Economic Weakness, Cite Strong Labor Market, Prioritize Inflation

- ~~“Overall economic activity appears to have picked up after edging down in the first quarter~~
- “Recent indicators of spending and production have softened”
- “Job gains have been robust in recent months, and the unemployment rate has remained low”
- “Committee is strongly committed to returning inflation to its 2 percent objective”

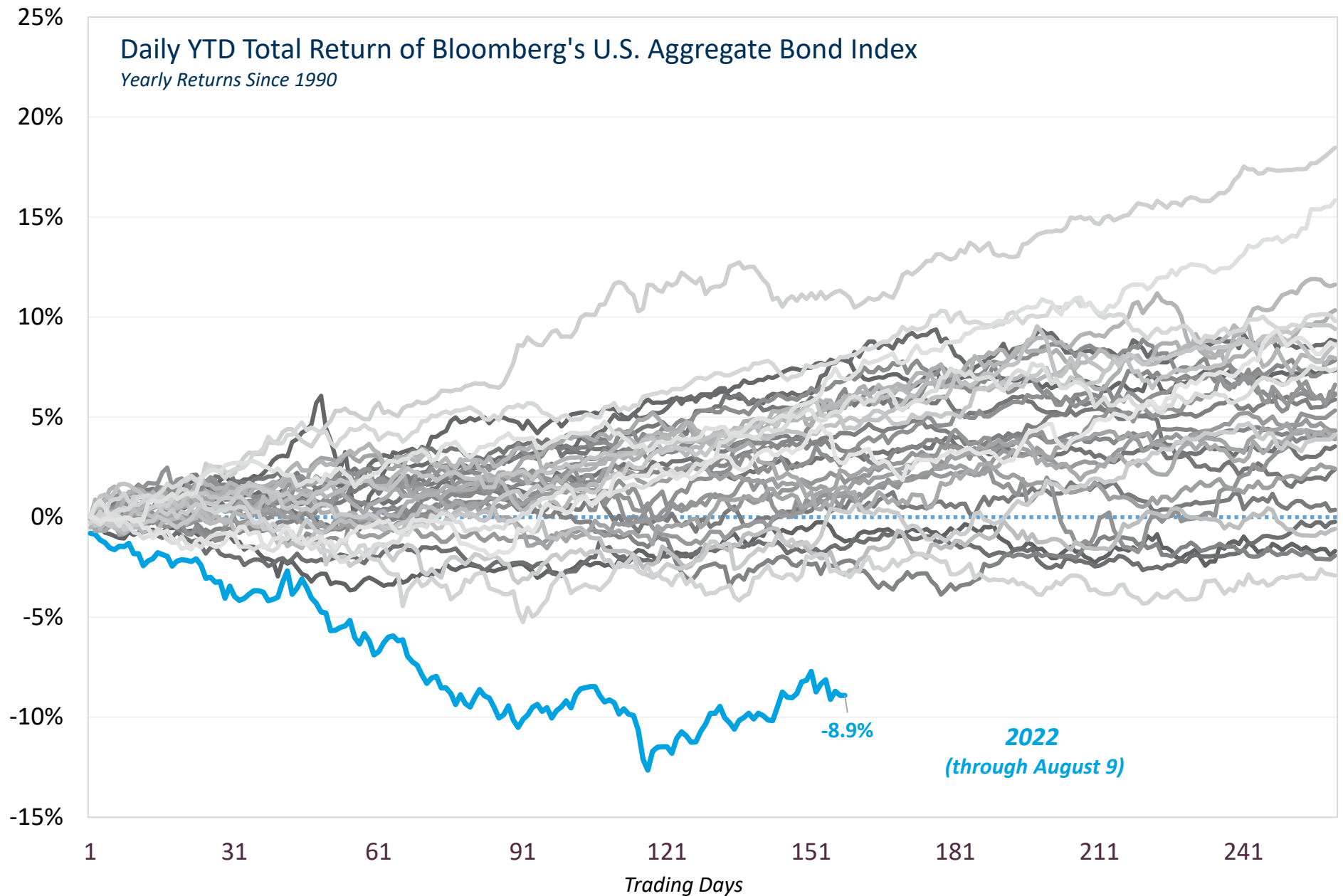
Fed Chair Powell’s Press Conference – Meeting-by-Meeting Now That Policy in Range of Neutral

- “It is essential that we bring inflation down to our 2 percent goal if we are to have a sustained period of strong labor market conditions”
- At neutral: “We’ve been saying we would move expeditiously to get to the range of neutral, and I think we’ve done that now”
- Meeting-by-meeting: Another “unusually large” [75 basis point] rate hike will depend on the data – a lot of data before September meeting
- Forward path: “I would say [the June SEP is] probably the best estimate of where the Committee's thinking is still. Which is that we would get to a moderately restrictive level by the end of this year, by which I mean somewhere between 3 and 3 1/2 percent”



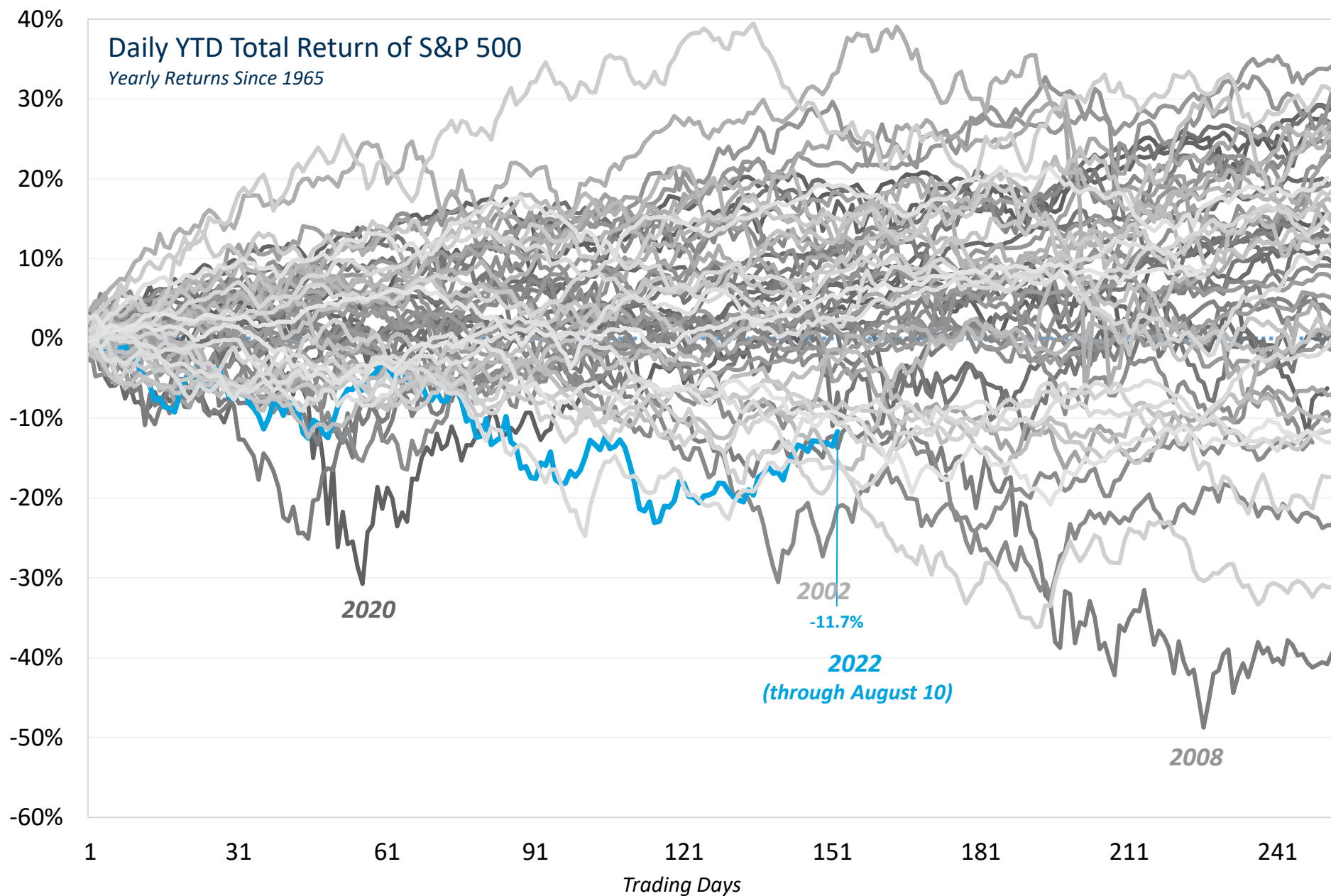
Bond Market Routed by Sharp Pivot from Fed

Historic Yield Surge Leads to Biggest Bond Rout Since at Least 1990, Giving Investors Nowhere to Hide



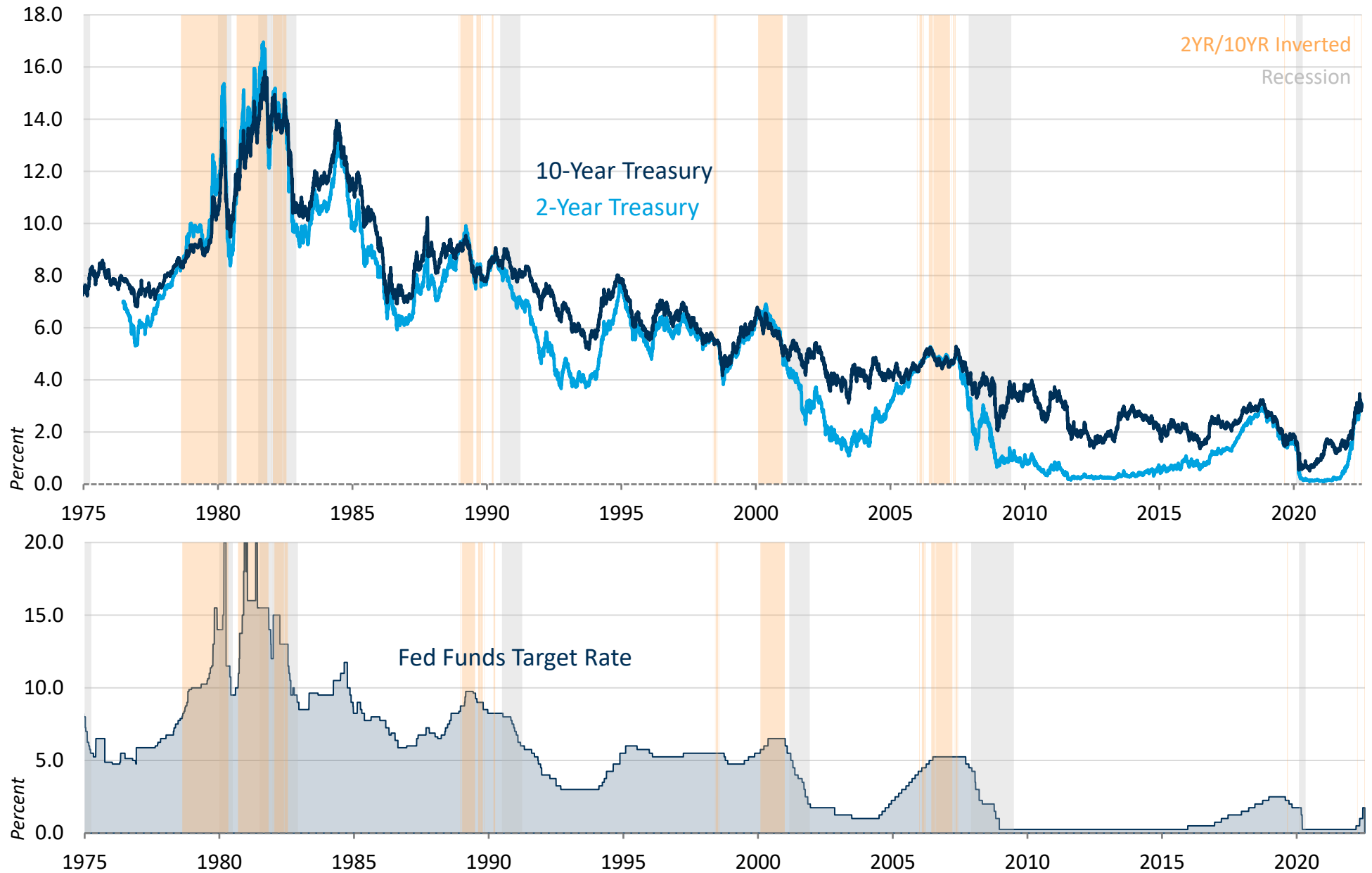
S&P 500 Off to Historically Bad Start after Setting Record High January 3

Rapid Increase in Yields Hands Stocks Worst First Half of Year Since 1970



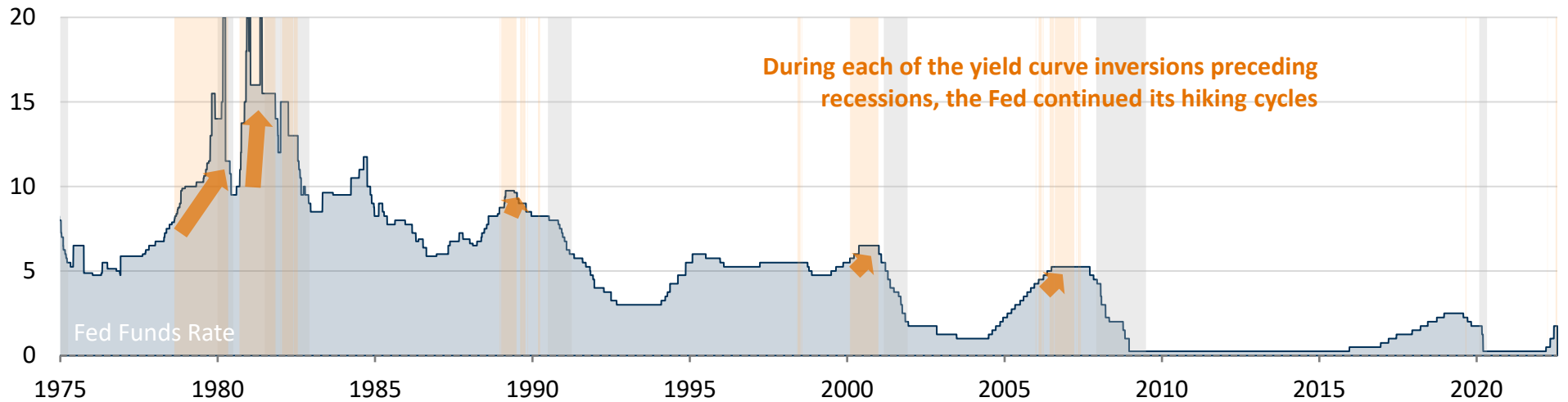
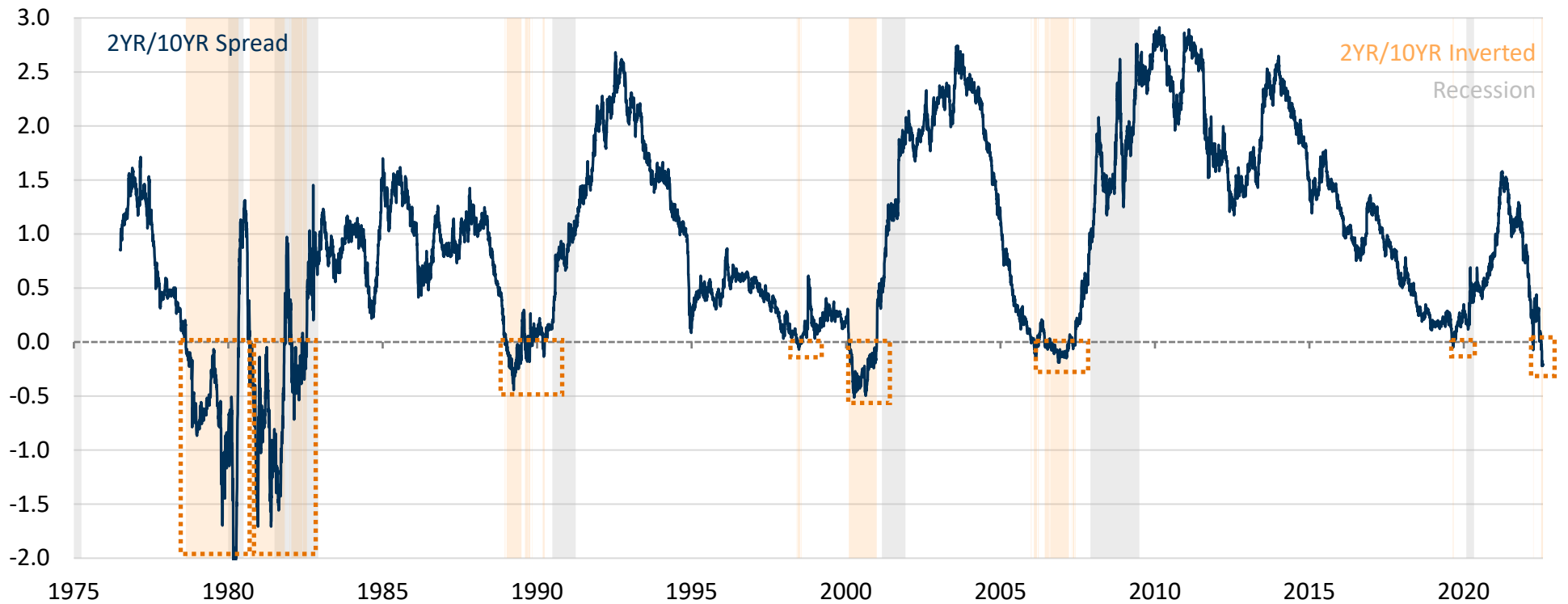
Yields Spike on Fed Pivot

2-Year Treasury, 10-Year Treasury, and Fed Funds



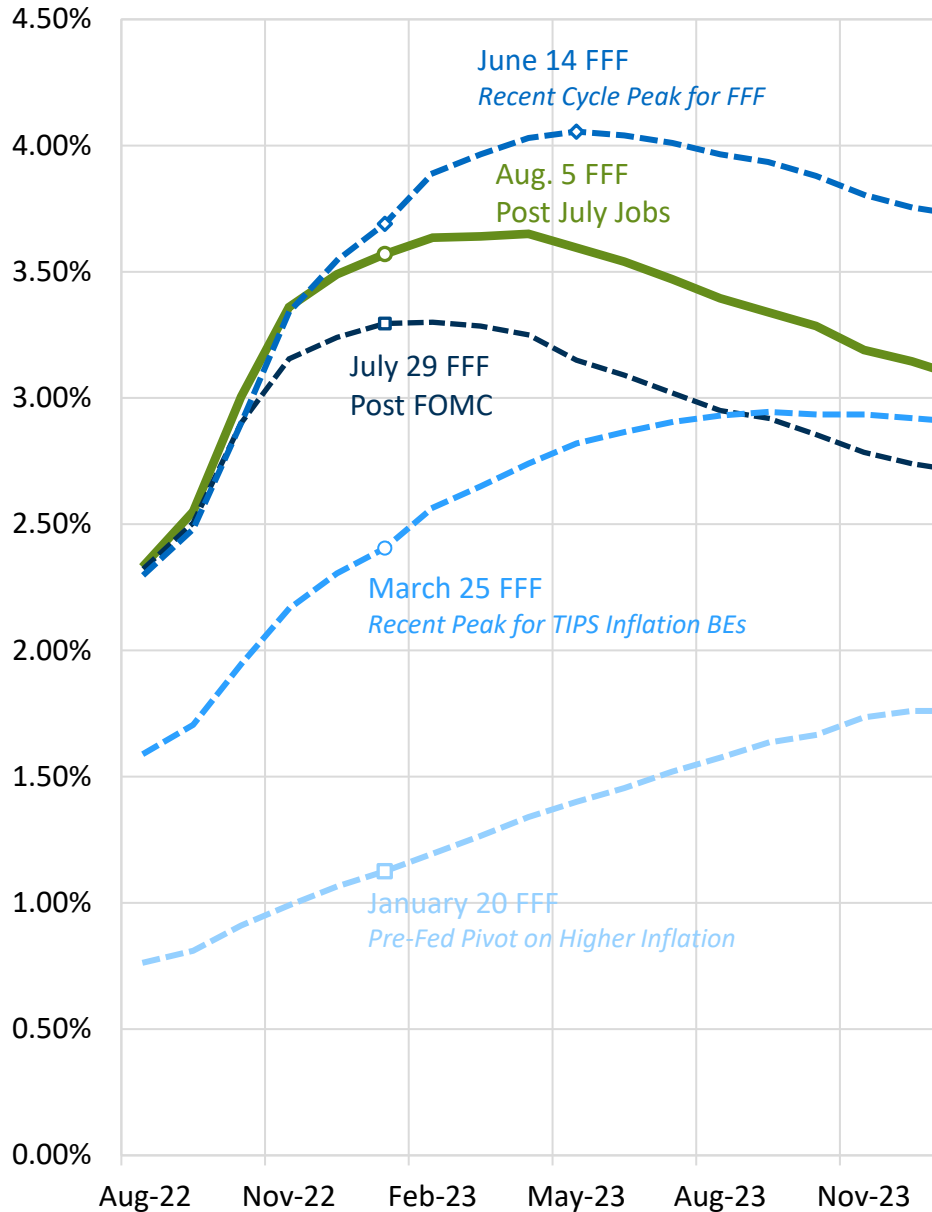
Yield Curve Inverts

2YR/10YR Spread (Percentage Points)

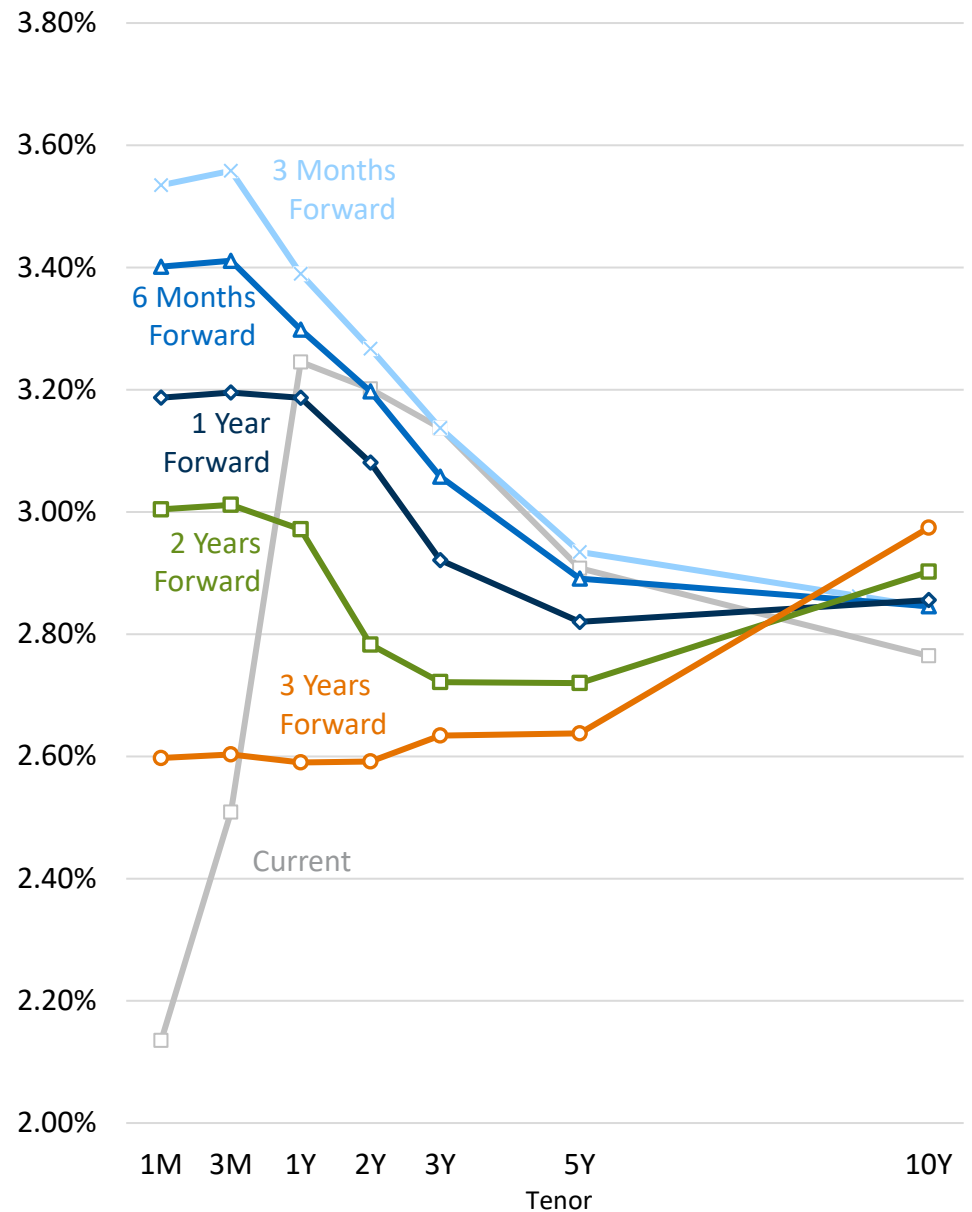


Forward Rates Imply Goldilocks Scenario

Fed Funds Futures | Early-2023 Peak

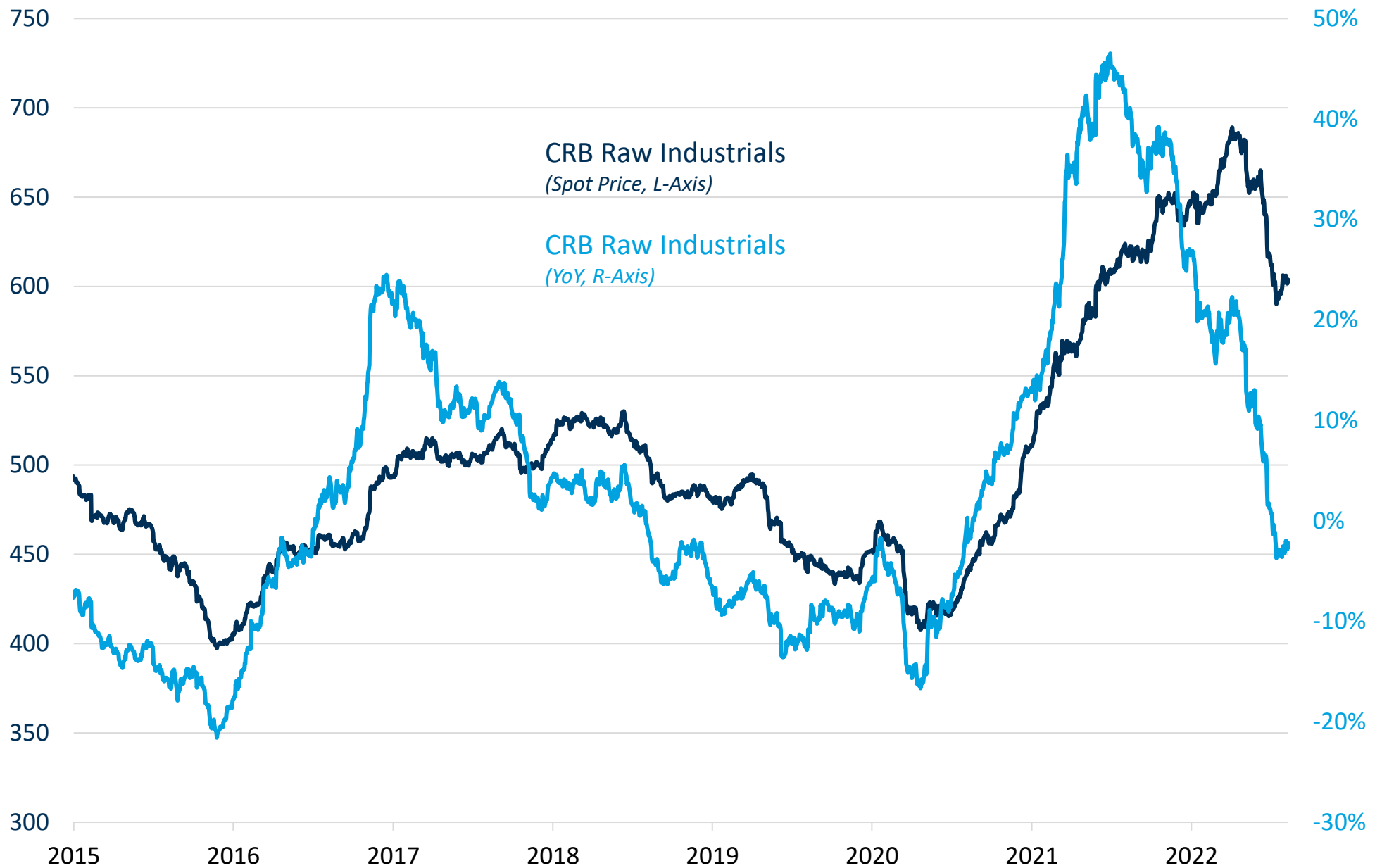


Forward Curve | Short End Higher before Dropping



Reasons for Optimism - Commodity Prices Portend Easing of Some Cost Pressures

CRB Raw Industrials Prices Turn Over but Remain Elevated



INVESTMENT STRATEGY:

- Follow the FED!!
- Focus on short maturity fixed income securities
- Consider longer maturity non-marketable certificates of deposit
- When the Fed pauses or cuts rates...extend maturities





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CLERK OF THE CIRCUIT COURT & COMPTROLLER
PALM BEACH COUNTY

Thank You

jburford@mypalmbeachclerk.com

561-355-2960

