

Insights

4Q2022 Core Total Return commentary

Market commentary

US Treasury market volatility remained elevated during the 4th quarter as the market continued to struggle with interpreting the Fed's policy and the ultimate level of the Fed Funds rate, as well as some changes in global monetary policy outside the US. The final month of the year saw increased volatility, with Treasury yields at the low end of the recent range heading into December. This was a reflection of US data in November, which showed signs that the economy was weakening and that inflation was finally trending downward, stoking more "pivot" rhetoric.

4Q2022 | Mesirow Strategic Fixed Income

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Core Total Return quarterly commentary

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This volatility earned for a few weeks with Treasury yields reaching quarters lows in mid-December. This all changed as the Bank of Japan sought market support for lowering its yield curve control policy to allow the yield on the 10-year JGB to move 50 basis points above rate of 0.75% target. As a result, global yields rose roughly 50 and the Fed strengthened significantly, while the market range has not been much compared to the volatility associated to central bank decisions. We saw a significant change in policy, higher rates in Japan would create incentives to bring money home versus investing in US and European debt.

Separately, US data which had appeared to create some relief about market volatility again showed some strength to close the year. This was reflected in continued volatility data, better than expected personal income reports and a Core PCE number that is still declining, a factor in better than expected at 0.7%. The inflation rate remained very close to the year ended and outlook rates on 10-year bonds points across the curve in the last few weeks of December.

Looking forward, we believe rates will remain volatile until bound in the near term, with 10-year Treasury rates trading in roughly a 50-basis point range (0.50% to 0.75%). The wider range in yields will have some as the market struggles to reconcile the opposing forces of elevated recession risk, a strong labor market that might prompt the Fed to continue their tightening path and a future impact that is still pricing in rate cuts in H2/23.

We believe Chairman Powell has been very transparent in his approach and will remain steadfast in his fight against inflation. We expect the FOMC to maintain their hiking path with some inflation still running over 2% their desired target. We do not believe we will see a pivot with the Fed cutting rates at any time in 2023. In fact, the recent economic data points to more of a soft landing. 2023 seems very material, plus on real disposable income set to begin during the year, and continued strength in the labor market. GDP growth may come in higher than what is currently expected by the market. We have remained consistent with our forecast and Fed Funds will deliver at least another 50 basis points of rate hikes at the coming meetings in February and March, with potential for that to surprise to the upside depending on the data.

Broader risk assets rebounded modestly during the fourth quarter. The US stock market, as measured by the S&P 500, first traded flat to rise for the year on October 12 at 3877 before rebounding to close the year at 3927, earning a 1% total return of 1.01%. For 2022, the S&P 500 achieved a total return of -18.13%, its worst year since 2008. Bond market performance was similar, with a sharp loss in December before rebounding to produce a 1% total return of 1.01%. The US bond market, as measured by the Bloomberg Aggregate Bond Index in 2022, achieved a total return of -13.13%, its worst year on record.

The 10-year UST yield started the year at 1.51% and peaked on October 24 at 4.24% before closing the year at 3.85%. The 2-year UST yield started the year at 0.70% and peaked on November 7 at 4.72% before closing the year at 4.45%.

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