July 2022

OREGON STATE TREASURY

Inside the Vault

Local Government Edition

Market Update

The May consumer price index (CPI) came in on June 10 at 8.6% year-over-year and 1.0% month-over-month, a rate of change greater than anticipated by the market consensus. There was hope of some slowdown in inflation over the spring or that price increases would be concentrated in areas impacted by the war in eastern Europe. However, the print delivered a broad-based increase across nearly all categories. The data was delivered five days before the June 15 meeting of the Federal Open Market Committee (FOMC), leading to some unusual backroom communications into the market to manage market views followed by a quick move in expectations and a relatively smooth digestion of a 75 basis point interest rate hike—the largest increase in 28 years.

The lingering question is how much will the interest rate increase impact inflation in the near term, in particular oil and food prices. Moreover, paradoxically, the increase in interest rates from zero is increasing the net interest margin on bank lending. So far, commercial loans have increased by 6% this year. This credit channel of monetary policy takes, on average, 12 to 18 months to filter into the economy and then, presumably, influence prices. This puts the onus of the Fed's policy on influencing aggregate demand and inflationary expectations rather than on credit creation.

Regarding the former, consumer spending for last month came in at 9.2% year-over-year. While it is dropping from the COVID-19 stimulus spike, it remains roughly double the post-Global Financial Crisis average. The shortest distance from monetary policy to U.S. consumer demand is asset prices, both home equity and the stock

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Interest Rates

Average Annualized Yield	
June	0.9333%

Interest Rates	
June 1–26	0.90%
June 27–30	1.15%

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market. The S&P 500 is down 20% from the start of the year, giving up all the gains from 2021. Meanwhile, the housing market is also coming off one of the best years on record, with the average home value increasing by roughly $60,000 in 2021 (versus an average U.S. annual wage of $55,000). The 30-year mortgage rate is up from 3.20% to 5.99% since January, leading to some early indicators of a sharp slowdown in the housing market (for instance, lumber prices are down 47% year-to-date).

How much consumer demand retracts from monetary policy is difficult to say, leaving the entire market “data dependent” and increasingly looking deeper into the data catalogue for higher frequency releases. Much has been made of Fed Chair Jerome Powell referencing the bimonthly University of Michigan’s inflation expectation survey, which has risen to 5.3% (from 4.8% at Dec. 31, 2021, and 2.5% at Dec. 31, 2020), the highest reading in more than 40 years (see chart at bottom). Also increasingly being followed by the market is the Cleveland Federal Reserve CPI Now (a real-time estimate of inflation), which in June alone climbed from 8.0% to 8.7%.

The increasing reliance on surveys and nowcast estimates is, to a large degree, because of the volatility in markets—in particular, bonds and commodities, which under normal conditions provide some signal of both price pressure and expectations. Commodity markets continue to trend up and are substantially higher than last year in most cases. As of this writing, however, the majority of commodity markets have declined from their recent highs. Energy, agriculture, and base metals—which are typically described as “choppy” with 1% to 2% daily movements—are regularly delivering 5% to 10% daily price swings. The global media report on food and energy inflation daily, leading to increased protests around the world as wages are not keeping pace with soaring food and fuel prices, thus crushing living standards.

The bond market is having its worst year on record. The volatility in interest rates, and the speed at which rates moved upward, is almost unprecedented. For example, 2-year Treasury notes ended 2021 at 0.74% and peaked at 3.43% the day before the FOMC meeting. Rates have drifted back down under 3% following the policy change. As of June 30, they were hovering around 2.96%. This type of sustained volatility in Treasurys is of concern to market participants, not only because the bond market is a signal of the broader economy, but also because the models used by bank and fund managers to measure risk are not built with these high-volatility movements in mind.

The Fed has made it clear to market participants that it intends to tame inflation. Increasingly, there is concern among market participants that as the Fed continues to tighten the money supply to get inflation under control, there may be a policy misstep and the Fed will “overshoot,” possibly leading to either a recession or to create idiosyncratic failures within the financial system. To date, neither has shown any evidence of occurring. As the quarter ends, however, the market is nestled in a period of extreme volatility dependent on each week’s macro data print.

Oregon Short Term Fund

The OSTF paid rate was raised on June 27 from 0.90% to 1.15%, representing the sixth increase this year. The fund’s 45% allocation to floating rate securities, benchmarked to 3-month Treasury bills, the Secured Overnight Financing Rate (SOFR), and Libor, will keep pace with the trend in short-term rates and, with four remaining FOMC meetings in 2022 and hikes of 50 to 75 basis points likely at each

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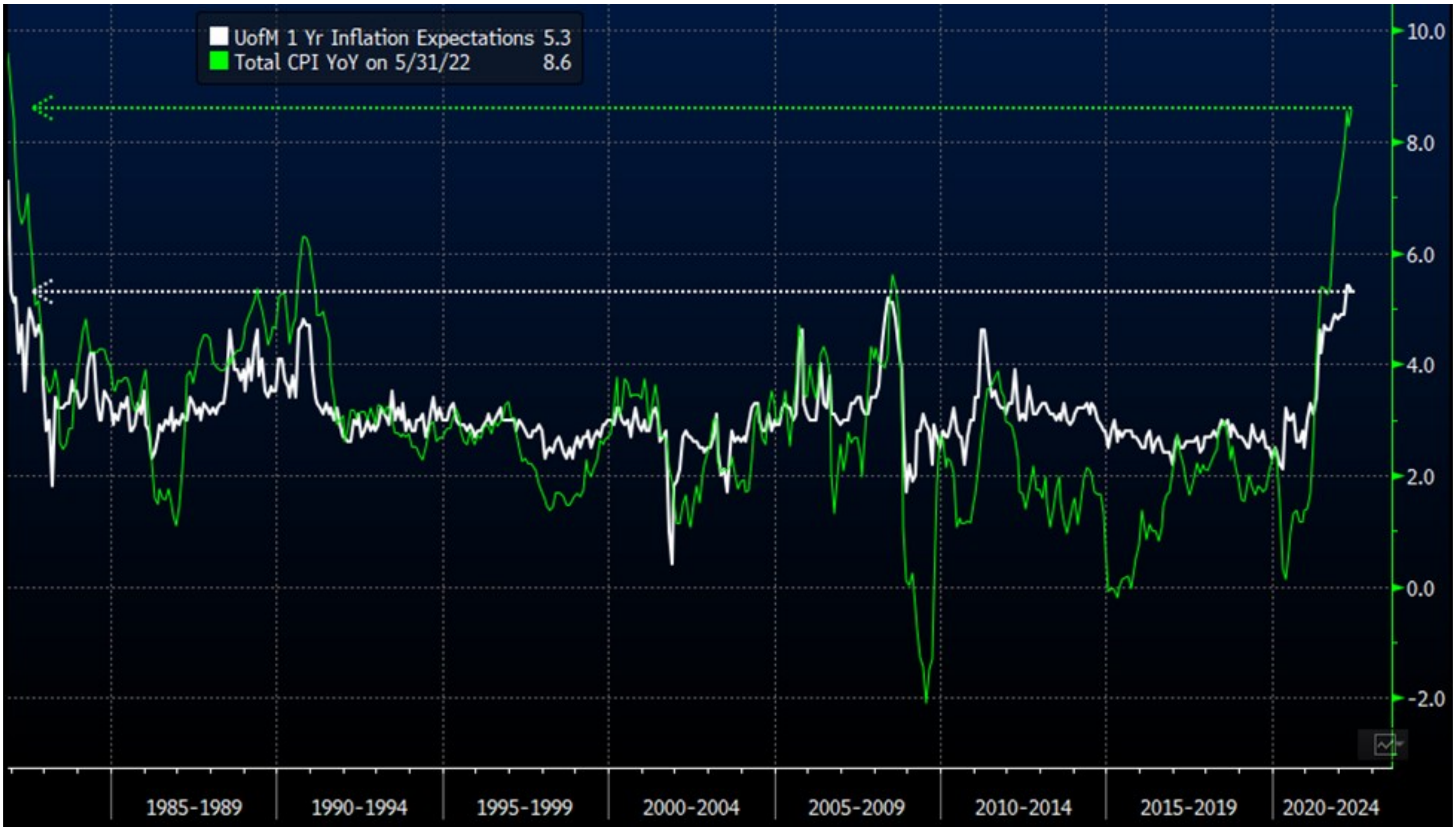
meeting, staff expects additional upward revisions to the paid rate in the near future. We remain focused on functioning in an open and transparent manner and, should you have questions, contact our Fixed Income Team at 503.431.7900.

Impact on Markets from December 2021 through June 2022

	12/31/2021	6/30/2022	Delta	Highlights
S&P 500	4,766	3,785	-20.0%*	Intraday low: 3,667 on 6/16
30-Year Treasury	1.904	3.185	+128 bps -22.9%*	Intraday low: 1.904 on 12/31
10-Year Treasury	1.512	3.016	+150 bps -11.3%*	Intrada low: 1.512 on 12/31
2-Year Treasury	0.734	2.957	+222 bps -2.98%*	Intraday low: 0.734 on 12/31
3-Month Treasury	0.044	1.667	+162 bps +0.14%*	Intraday low: 0.044 on 12/31

**Total Return (dividends reinvested for S&P; price and income for Treasurys)*

Consumer Price Inflation and 1-year Inflation Expectations at highest levels since 1981



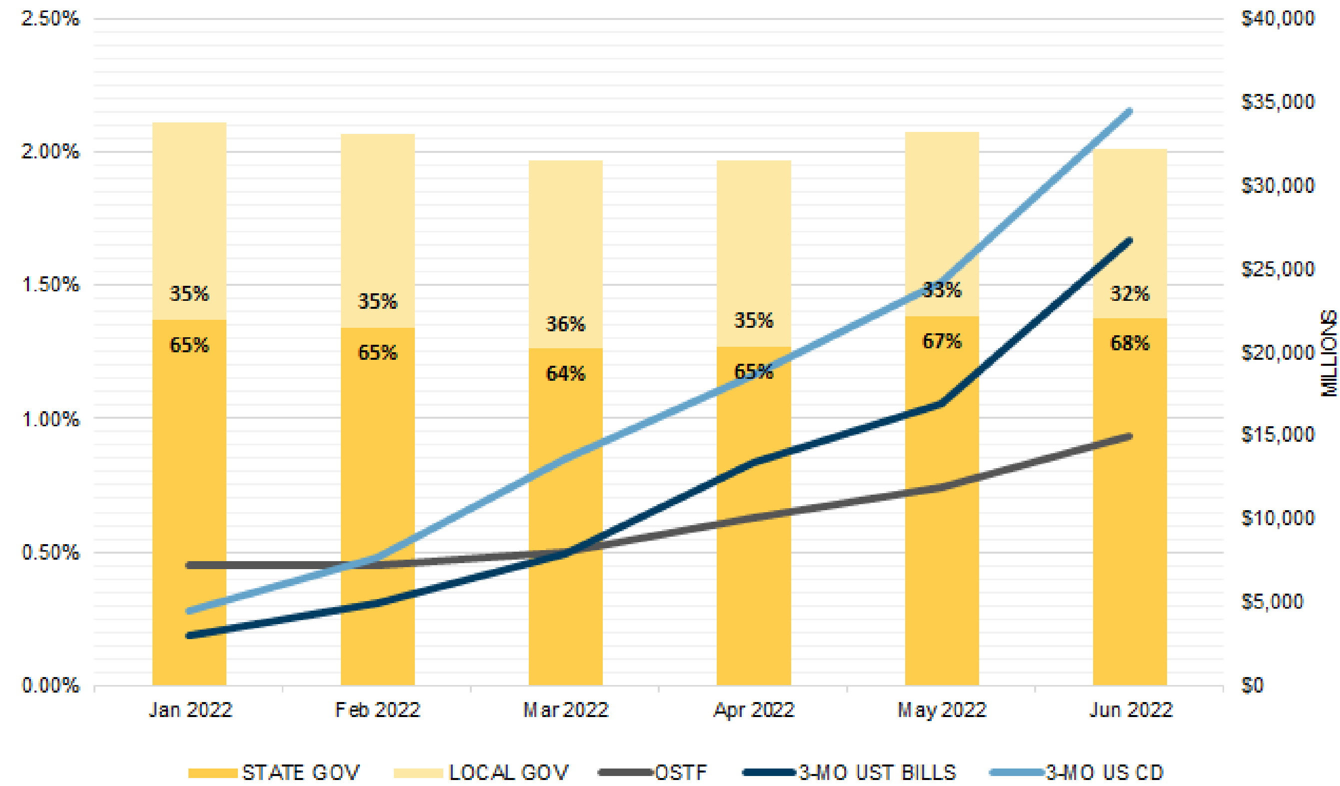
LGIP: Audit Confirmation Requests

Auditors needing confirmation of Local Government Investment Pool account balances must submit requests in writing to PFMAM Client Services. Requests must include or be accompanied by a release signed by a participant's authorized contact (the contact must be registered in the records of the pool and have permission to view/access pool account information). Requests/releases can be submitted through Connect, faxed to 888.535.0120, or mailed to:

Oregon LGIP
PO Box 11760
Harrisburg, PA 17108-1760

For help with submitting an audit confirmation request, contact PFMAM Client Services at 855.OST.LGIP.

Oregon Short Term Fund Analysis



	Jan 2022	Feb 2022	Mar 2022	Apr 2022	May 2022	Jun 2022
TOTAL OSTF AVG DOLLARS INVESTED (MM)	33,737	33,050	31,437	31,534	33,245	32,158
STATE GOV PORTION (MM)	21,950	21,506	20,147	20,340	22,145	21,998
LOCAL GOV PORTION (MM)	11,787	11,544	11,290	11,194	11,100	10,160
OSTF ANNUAL YIELD (ACT/ACT)	0.45	0.45	0.50	0.63	0.75	0.93
3-MO UST BILLS (BOND EQ YLD)	0.186	0.307	0.496	0.834	1.058	1.667
3-MO US CD (ACT/360)*	0.28	0.48	0.85	1.16	1.51	2.15

NOTE: The OSTF ANNUAL YIELD represents the average annualized yield paid to participants during the month. Since interest accrues to accounts on a daily basis and the rate paid changes during the month, this average rate is not the exact rate earned by each account.

3-MO UST BILLS yield is the yield for the Treasury Bill Issue maturing closest to 3 months from month end. 3-MO US CD rates are obtained from Bloomberg and represent a composite of broker dealer quotes on highly rated (A1+/P1/F1+ from Standard & Poor's Ratings Services, Moody's Investors Service and Fitch Ratings respectivley) bank certificates of deposit and are quoted on a CD equivalent yield basis.

Market Data Table

	6/30/2022	1 Month	3 Months	12 Months		6/30/2022	1 Month	3 Months	12 Months
7-Day Agency Discount Note**	1.32	0.57	0.13	0.03	Bloomberg Barclays 1-3 Year Corporate YTW*	3.82	3.17	2.78	0.53
30-Day Agy Nt Disc**	1.37	0.72	0.15	0.03	Bloomberg Barclays 1-3 Year Corporate OAS*	0.93	0.73	0.59	0.31
90-Day Agy Nt Disc**	1.79	1.15	0.47	0.03	Bloomberg Barclays 1-3 Year Corporate Modified Duration*	1.95	1.97	1.91	1.87
180-Day Agy Nt Disc**	2.18	1.40	0.95	0.03					
360-Day Agy Nt Disc**	2.07	2.07	2.34	0.03	7-Day Muni VRDN Yield**	0.91	0.79	0.51	0.03
					O/N GGC Repo Yield**	1.47	0.81	0.09	0.06
30-Day Treasury Bill**	0.85	0.64	0.07	0.03					
60-Day Treasury Bill**	1.40	0.86	0.30	0.03	Secured Overnight Funding Rate (SOFR)**	1.50	0.79	0.29	0.05
90-Day Treasury Bill**	1.68	1.06	0.52	0.03					
6-Month Treasury Yield**	2.49	1.57	1.02	0.05	US 10 Year Inflation Break-Even**	2.34	2.65	2.83	2.34
1-Year Treasury Yield**	2.78	2.07	1.61	0.07					
2-Year Treasury Yield**	2.96	2.56	2.34	0.25	1-Day CP (A1/P1)**	1.51	0.74	0.30	0.16
3-Year Treasury Yield**	3.01	2.73	2.51	0.46	7-Day CP (A1/P1)**	1.53	0.77	0.31	0.15
					30-Day CP (A1/P1)**	1.71	1.04	0.42	0.12
1-Month LIBOR**	1.79	1.12	0.45	0.10					
3-Month LIBOR**	2.29	1.61	0.96	0.15	30-Day CD (A1/P1)**	1.72	1.04	0.46	0.07
6-Month LIBOR**	2.94	2.11	1.47	0.16	90-Day CD (A1/P1)**	2.25	1.46	0.89	0.10
12-Month LIBOR**	3.62	2.74	2.10	0.25	6-Month CD (A1/P1)**	2.87	2.01	1.37	0.14
Sources: *Bloomberg Index Services, **Bloomberg					1-Year CD (A1/P1)**	3.57	2.80	2.19	0.20

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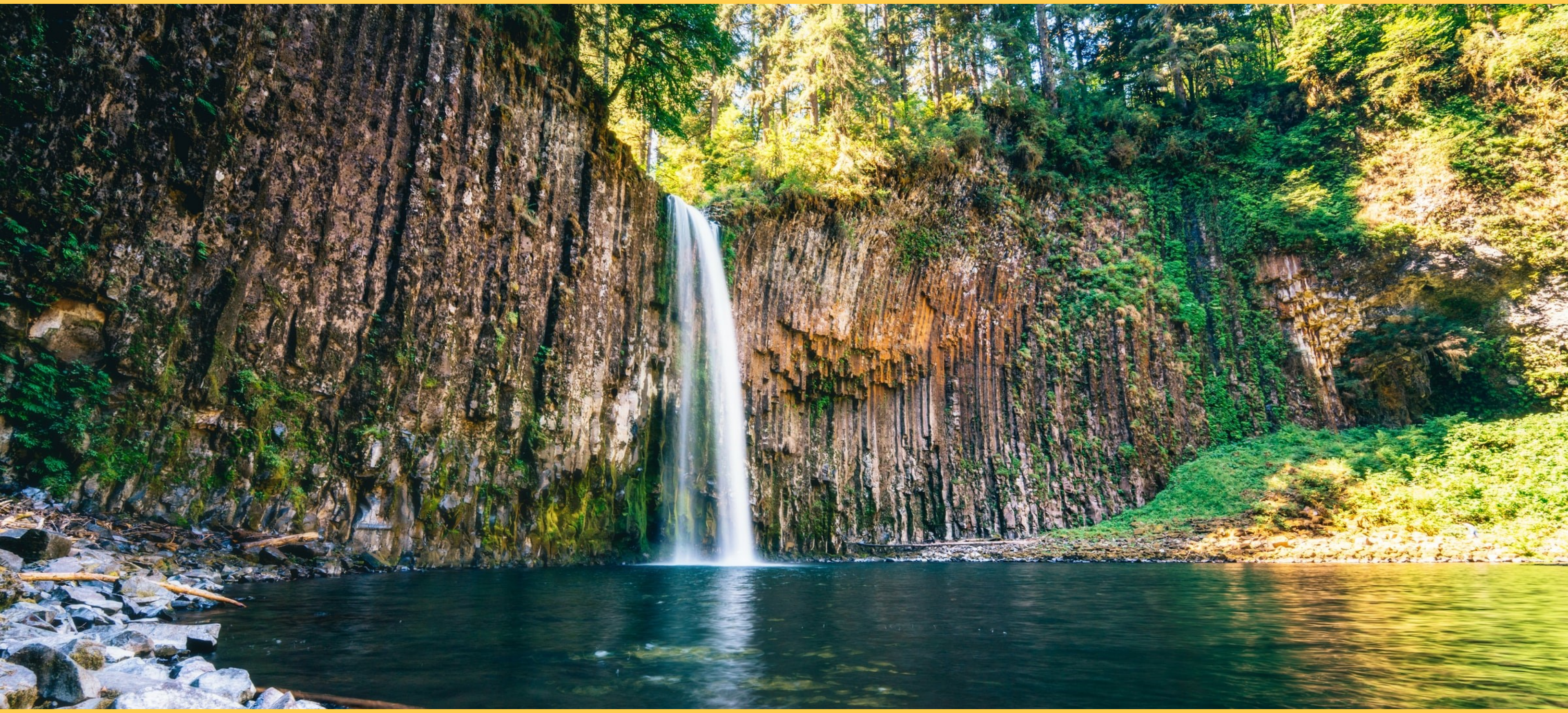

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