CHANDLER ASSET MANAGEMENT

Economic highlights from the week ending on August 28, 2020

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Fed Chair Powell delivered a speech at the annual Economic Policy Symposium (typically held in Jackson Hole but live-streamed this year due to the pandemic) yesterday. As largely expected, Chair Powell unveiled a modest shift to the Fed's monetary policy framework. While the Fed is not abandoning its 2.0% inflation target, the Fed will now seek to achieve inflation that averages 2.0% over time. Should the labor market tighten, the Fed will put less emphasis on preemptive monetary policy tightening to prevent an overshoot of inflation. Instead, the Fed will wait for evidence that inflation is heating up and allow inflation to run above 2.0% for some (unspecified) period of time before it looks to tighten policy. The Fed's updated framework essentially signals that the fed funds target rate (currently in a range of 0.0%-0.25%) is likely to stay low for an extended period of time. In our view, an important nuance of the Fed's updated policy framework is that future decisions about monetary policy will be based on a range of subjective factors, and not based on a specific unemployment rate or a formulaic approach. The Fed's decisions about monetary policy will be based on a confluence of factors and the judgement of Fed policymakers, but they will not be bound by specific numerical targets. Overall, Fed Chair Powell's announcement this week was not a surprise to the financial markets and does not represent an unexpected or drastic shift in the outlook for monetary policy. We have long anticipated that the Fed would likely allow inflation to rise modestly above 2.0% before pursuing a more aggressive monetary policy tightening and Fed Chair Powell's speech this week confirms this view. Overall, the Fed continues to be dovish and remains focused on using its tools to support smooth financial market functioning.

The Fed's highly accommodative monetary policy framework, along will a swift and robust fiscal policy response from the government earlier this year, has clearly provided support for the financial markets this year amid a very challenging economic backdrop. Year-to-date, the S&P 500 index is up more than 8% and has more than recovered all of its pandemic-fueled decline. The equity market rally has largely been led by the tech sector, and the tech-heavy Nasdaq index is up roughly 30% year-to-date. Corporate credit spreads, or the additional compensation investors receive for purchasing non-US treasury securities, have tightened by more than 260 basis points since March 23rd (based on the ICE BofA US Corporate Index) after panic-driven corporate credit spread widening in the initial stage of the pandemic. On a year-over-year basis, the average option-adjusted spread on investment grade corporates is only about 13 basis points wider.

The Fed's signaling of lower policy rates for longer, along with a recent wave of long-term Treasury bond issuance to fund the growing fiscal deficit, has put modest upward pressure on longer-term Treasury rates and inflation expectations. The Treasury yield curve continued to steepen this week, with the 10-year Treasury yield up more than 10 basis points to 0.73% at the time of this report. Month-to-date, the 10-year Treasury yield has increased more than 20 basis points in August, while shorter-term rates have remained anchored near zero. Market-based measures of future inflation have been steadily creeping higher over the past month and the US 5-year, 5-year forward breakeven rate (a measure of expected inflation over the five-year period that begins five years from today) is now back near its one-year pre-pandemic high.

Next Week

ISM Manufacturing, Construction Spending, Beige Book, Productivity & Costs, ISM Services Index, Employment

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**S&P 500*– The S&P 500 is a market value weighted index of 500 large-capitalization stocks. The 500 companies included in the index capture approximately 80% of available US market capitalization. NASDAQ–The NASDAQ Composite Index is the market capitalization-weighted index of over 3.300 common stocks listed on the NASDAQ stock exchange.* *The ICE BofA US Corporate Index - tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule and a minimum amount outstanding of $250 million. Original issue zero coupon bonds, 144a securities (with and without registration rights), and pay-in-kind securities (including toggle notes) are included in the index. Callable perpetual securities are included provided they are at least one year from the first call date. Fixed-to-floating rate securities are included provided they are callable within the fixed rate period and are at least one year from the last call prior to the date the bond transitions from a fixed to a floating rate security. Contingent capital securities ("cocos") are excluded, but capital securities where conversion can be mandated by a regulatory authority, but which have no specified trigger, are included. Other hybrid capital securities, such as those issues that potentially convert into preference shares, those with both cumulative and non-cumulative coupon deferral provisions, and those with alternative coupon satisfaction mechanisms, are also included in the index. Equity-linked securities, securities in legal default, hybrid securitized corporates, Eurodollar bonds (USD securities not issued in the US domestic market), taxable and tax-exempt US municipal securities and DRD-eligible securities are excluded from the index.*

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