Citizens Market Update

July 11, 2023

- Inflation rose 0.1% in May after increasing 0.4% in April. Over the last 12 months, the all items index increased 4.0% before seasonal adjustment – this was the smallest 12-month increase since the period ending March 2021. The index for all items less food and energy rose 0.4 percent in May, as it did in April and March, and rose 5.3% over the last 12 months. The energy index decreased 11.7% for the 12 months ending May, and the food index increased 6.7% over the last year.
- Total nonfarm payroll employment increased by 209,000 in June, and the unemployment rate changed little at 3.6%, which was below market estimates. Both the unemployment rate, at 3.6%, and the number of unemployed persons, at 6.0 million, changed little in June. The unemployment rate has ranged from 3.4% to 3.7% since March 2022. In June, the labor force participation rate was 62.6% for the fourth consecutive month, and the employment-population ratio, at 60.3%, was unchanged over the month.
- The strong labor market along with high wage level makes it almost certain that the Fed will hike rates again this month – the market is showing 90% probability of a quarter-point hike on July 26th. The Fed indicated at their June gathering that two more rate hikes could be ahead in 2023.
- There is still a strong likelihood of a recession in the second half of the year. While the most widely accepted definition of a recession is two consecutive quarters of declining GDP, and quarterly GDP remains positive having increased by an annual rate of 2.0% in the first quarter of 2023. All the other typical signs of a recession are present: an inverted yield curve, rising interest rates, and high inflation. One of the reasons we have been able to avoid recession, so far is continuous large government spending through various programs even beyond 2020 programs - 2021 American Rescue Plan, 2021 Infrastructure and Jobs Act, 2022 Inflation Reduction Act, and 2022 Chips Act. However, this on the other hand has added to the inflation.
- Global markets are in similar position as Global Central Banks followed the Fed's monetary policy and US fiscal policy during the COVID lockdown and now the world is trying to play catch up by increasing interest rates.
- Rates have increased significantly to reflect Fed rate increases, particularly on the long-end of the curve, but the yield curve remains significantly inverted with the spread between the 3-month and 30-year Treasury at 1.45% and the spread between the 2-year and 10-year Treasury at 0.98%. Since the beginning of the year, the 1-year UST has increased from 4.87% to 5.44%, the 2-year UST has increased from 4.32% to 4.99%, the 5-year UST has increased from 3.76% to 4.37% and the 10-year UST has increased from 3.63% to 4.05%.

U.S. Treasury Rates					
	1-Year	**2-Year**	**5-Year**	**10-Year**	**2-10 Yr Spread**
Current (7/6)	**5.44**	**4.99**	**4.37**	**4.05**	**(0.94)**
Beginning of 2023 (1/2)	4.87	4.32	3.76	3.63	(0.69)
1-Yr Prior	2.87	3.03	3.05	3.01	(0.02)
2-Yrs Prior	0.07	0.22	0.81	1.37	1.15
3-Yrs Prior	0.16	0.16	0.31	0.69	0.53
5-Yrs Prior	2.34	2.57	2.75	2.87	0.30
5-Yr Average	1.81	1.82	1.93	2.14	0.32
10-Yr Average	1.25	1.39	1.81	2.23	0.84
Current as % Above / Below 5-Yr Average	201%	174%	127%	89%	-394%
Current as % Above / Below 10-Yr Average	336%	259%	141%	81%	-211%

- The result of higher interest rates, lower equity prices, significant mark to market losses, and the pressure on global banking sector continues, which has reduced lending to small and medium businesses and will eventually lead to higher unemployment and economic slowdown and most likely will lead to recession over the next 6-9 months – even though some of the sectors have slowed down.
- While the recent increase in interest rates has increased the negative mark-to-market in our investment portfolio, the current MTM is negative $854 million, these values are non-economic and non-cash as these negative values pull to par as they mature. Our portfolio duration is much shorter today than it was a year ago, so the evaporation pace will increase.
- Lastly, our income return is stable and rising interest rates are economically beneficial as they lead to higher interest income and we will get the benefit of higher rates by continuing to invest remaining portion of our portfolio, after Ian's claims, of our maturing securities as well as additional premiums at higher rates.