CHANDLER ASSET MANAGEMENT

October 2015

# BOND MARKET REVIEW

A MONTHLY REVIEW OF FIXED INCOME MARKETS

WHAT'S INSIDE



Since 1988, Chandler Asset Management has specialized in the management of fixed income portfolios. Chandler's mission is to provide fully customizable, client-centered portfolio management that preserves principal, manages risk and generates income in our clients' portfolios.

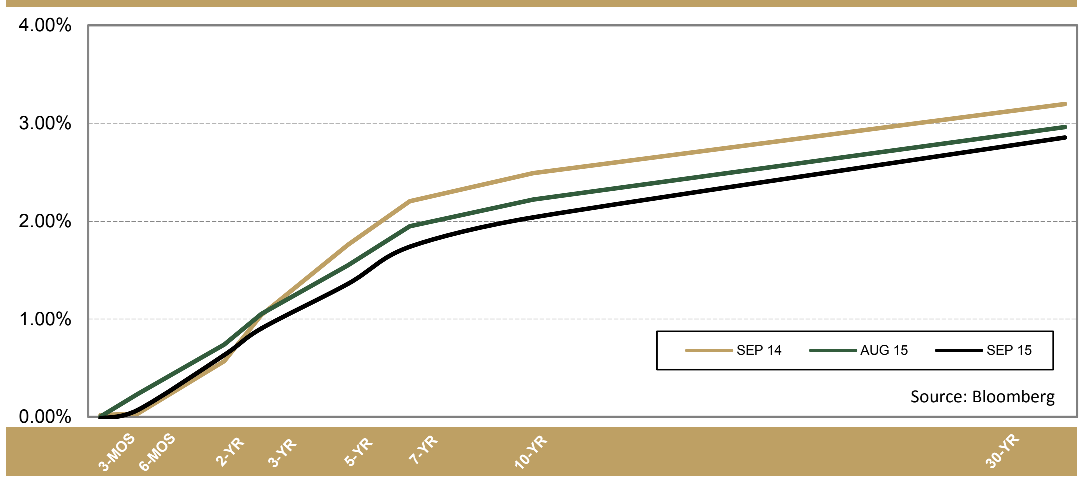
## Market Summary

In light of the weak September jobs report and the latest reading on inflation, we believe the probability of a fed funds rate hike by the Federal Reserve before year-end has further diminished. Nonfarm payrolls rose by 142,000 in September, below the consensus forecast of 201,000. Meanwhile, the PCE price index is still running well below the Fed's 2.0% target, at just 0.3% on a year-over-year basis in August. In our view, a rate hike is still possible before year-end, but depending on domestic and global economic data, as well as any potential financial market volatility fueled by a US debt ceiling debate over the next few months, it could be pushed out to 2016. Fed funds futures currently imply that the Fed could remain on hold until March or even June of next year. The Federal Open Market Committee (FOMC) left policy rates unchanged at its September meeting. The Committee cautioned that "recent global economic and financial developments may restrain economic activity." Overall, the Fed's September policy statement was dovish and the outlook for future monetary policy changes remains uncertain.

US economic data has been mixed. Over the past three months, payrolls have increased by an average of 167,000 per month, compared to the trailing six-month average of 199,000. In September the unemployment rate was unchanged at 5.1%, but the participation rate edged down and wages were flat. Meanwhile, housing still appears to be a growing source of strength for the US economy. In addition, consumer confidence remains strong, which should bode well for fourth quarter holiday shopping. The manufacturing sector, on the other hand, remains under pressure, largely due to the strength of the US dollar. Second quarter GDP growth was revised upward to an annualized rate of 3.9% from the second estimate of 3.7%. Market participants currently expect annualized GDP growth of about 2.4% in the third quarter, and 2.7% growth in the fourth quarter.

Interest rate volatility remains elevated due to continued uncertainty regarding the outlook for global economic growth and the timing of the first fed funds rate hike. Yields on 2-year and 10-year Treasury notes declined in September, offsetting increases in August. Mixed US economic data, divergent central bank monetary policies, and concerns about weakening economic growth in China and other emerging markets have influenced interest rates.

### TREASURY YIELDS HAVE BEEN VOLATILE




Interest rate volatility remains elevated. The yield on the two-year Treasury note fell about 8 basis points in September after increasing by approximately the same amount in August. Meanwhile, the yield on the ten-year Treasury note fell roughly 12 basis points in September after increasing about 4 basis points in August. Concerns about slowing global economic growth, the continued decline in oil prices and ongoing uncertainty about Fed monetary policy has fueled financial market turbulence.

| TREASURY YIELDS | 9/30/2015 | 8/31/2015 | CHANGE |
|---|---|---|---|
| 3 Month | (0.02) | 0.00 | (0.02) |
| 2 Year | 0.63 | 0.74 | (0.11) |
| 3 Year | 0.90 | 1.05 | (0.15) |
| 5 Year | 1.36 | 1.55 | (0.19) |
| 7 Year | 1.74 | 1.95 | (0.21) |
| 10 Year | 2.04 | 2.22 | (0.18) |
| 30 Year | 2.85 | 2.96 | (0.11) |

*Source: Bloomberg*

# Economic Roundup

**Consumer Prices**

In August, Consumer Price Index (CPI) inflation was unchanged from July, up 0.2% on a year-over-year basis. Headline inflation remains low, in light of a precipitous decline in energy prices. The year-over-year Core CPI (CPI less food and energy) was also unchanged at 1.8% in August. The Personal Consumption Expenditures (PCE) price index was unchanged in August, up 0.3% on a year-over-year basis. The Core PCE price index was up 1.3% on a year-over-year basis in August, up slightly from 1.2% in July. Overall, inflation remains below the Fed's 2.0% target.

**Retail Sales**

Retail sales rose 0.2% on a month-over-month basis in August, following an upwardly revised gain of 0.7% in July. On a year-over-year basis, retail sales rose 2.2% in the month, following a 2.6% year-over-year gain in July. The July and August gains signal an improving trend in consumer spending. Ongoing improvement in the labor market, along with low gas prices, should continue to have a positive influence on consumer discretionary spending.

**Labor Market**

The September employment report was weaker than expected. Nonfarm payrolls rose by 142,000 in September, well below the consensus forecast of 201,000. July and August payrolls were revised down by a total of 59,000. The unemployment rate was unchanged at 5.1% in September. Meanwhile, the participation rate declined to 62.4% from 62.6%, to its lowest level since 1977. A broader measure of unemployment called the U-6, which includes those whom are marginally attached to the labor force and employed part time for economic reasons, declined to 10.0% from 10.3%. Wages were flat on a month-over-month basis in September, and were up 2.2% on a year-over-year basis. Over the past three months, payrolls have increased by an average of 167,000 per month, compared to the trailing six-month average of 199,000.

**Housing Starts**

Total housing starts fell 3.0% in August, below expectations. Both single-family housing starts and multi-family starts fell 3.0%. However, total housing starts are up 16.6% year-over-year, with single-family starts up 14.9% and multi-family starts up 19.8% on that basis. Housing data tends to be volatile on a month-to-month basis, but the underlying trends suggest the housing sector is a growing source of strength for the US economy.

# Credit Spreads Widened in September

| CREDIT SPREADS | Spread to Treasuries (%) | One Month Ago (%) | Change (%) |
|---|---|---|---|
| 3-month top-rated commercial paper | 0.25 | 0.22 | 0.03 |
| 2-year A corporate note | 0.67 | 0.67 | 0.00 |
| 5-year A corporate note | 1.04 | 0.99 | 0.05 |
| 5-year Agency note | 0.24 | 0.25 | (0.01) |

*Source: Bloomberg* *Data as of 9/30/2015*

# Economic Data Has Been Mixed

| ECONOMIC INDICATOR | Current Release | Prior Release | One Year Ago |
|---|---|---|---|
| Trade Balance | (48.3) $Bln AUG 15 | (41.8) $Bln JUL 15 | (41.3) $Bln AUG 14 |
| GDP | 3.9% JUN 15 | 0.6% MAR 15 | 4.6% JUN 14 |
| Unemployment Rate | 5.1% SEP 15 | 5.1% AUG 15 | 5.9% SEP 14 |
| Prime Rate | 3.25% SEP 15 | 3.25% AUG 15 | 3.25% SEP 14 |
| CRB Index | 193.76 SEP 15 | 202.09 AUG 15 | 278.55 SEP 14 |
| Oil (West Texas Int.) | $45.09 SEP 15 | $49.20 AUG 15 | $91.16 SEP 14 |
| Consumer Price Index (y/o/y) | 0.2% AUG 15 | 0.2% JUL 15 | 1.7% AUG 14 |
| Producer Price Index (y/o/y) | (2.9%) AUG 15 | (2.6%) JUL 15 | 2.3% AUG 14 |
| Dollar/EURO | 1.12 SEP 15 | 1.12 AUG 15 | 1.26 SEP 14 |

*Source: Bloomberg*