CHANDLER ASSET MANAGEMENT

BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

MARCH 2017

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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.

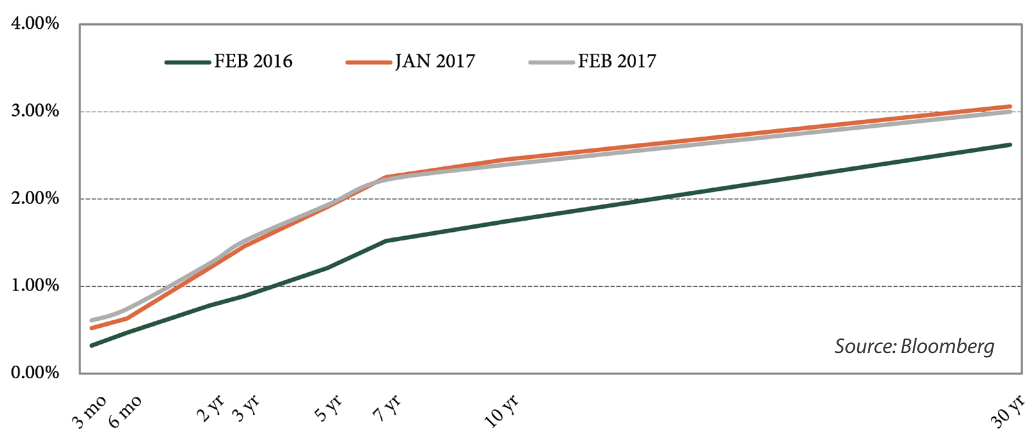
Market Summary

A rate hike has become all but certain at the upcoming March 14-15 Federal Open Market Committee (FOMC) meeting. Several Fed policymakers have spoken publicly about the possibility of a rate hike, and recent comments by Fed Chair Janet Yellen affirmed a rate hike this month is likely. Economic conditions are generally supportive of another rate hike, particularly given inflation is approaching the Fed's 2.0% target and the economy is close to full employment. We believe the Federal Reserve has an incentive to get another rate hike under their belt soon, as the calendar may become more challenging later this year due to European elections. Several FOMC members have also noted the importance of not waiting too long to hike rates, in order to avoid having to be aggressive with tightening down the road. We believe the pace of policy tightening will remain gradual as the neutral interest rate will likely rise only slowly, due in part to global economic conditions as well as sluggish US productivity growth. We also believe the Fed is unlikely to be too aggressive with policy tightening, until there is more clarity around the timing and magnitude of fiscal stimulus and tax reform.

Domestic economic data remains indicative of slow growth. The economy is close to full employment, consumer confidence is strong, manufacturing trends have improved, and housing trends remain favorable. Looking further ahead, a potential boost in fiscal stimulus could provide a further tailwind to economic growth.

The Treasury yield curve flattened slightly in February. For the month, the 2-year Treasury yield increased nearly six basis points and the 10-year Treasury yield decreased roughly six basis points. At the end of 2016 following the election, US Treasury yields increased meaningfully, driven by heightened expectations for fiscal stimulus and growth under the new Trump administration and Republican-controlled Congress. However, US Treasury yields have been generally range-bound over the past few months.

The Treasury Yield Curve Steepened:



On a year-over-year basis the 2-year Treasury yield has increased 49 basis points and 10-year Treasury yield is up about 66 basis points. The yield curve steepened dramatically after the election in November but has modestly flattened in recent months. Over the past year, Treasury yields have been influenced by sluggish global economic growth, volatile commodity prices, political uncertainty, and divergent global central bank monetary policy.

TREASURY YIELDS	Trend (▲/▼)	2/28/2017	1/31/2017	Change
3-Month	▲	0.61	0.52	0.09
2-Year	▲	1.26	1.21	0.05
3-Year	▲	1.52	1.46	0.06
5-Year	▲	1.93	1.91	0.02
7-Year	▼	2.22	2.25	(0.03)
10-Year	▼	2.39	2.45	(0.06)
30-Year	▼	3.00	3.06	(0.06)

Source: Bloomberg

Market Data

World Indices
data as of 2/28/2017

	Diff. (1/31/17)	% Change
S&P 500		
2,363.64	84.77	3.72%
NASDAQ		
5,825.44	210.65	3.75%
DOW JONES		
20,812.24	948.15	4.77%
FTSE (UK)		
7,263.44	164.29	2.31%
DAX (Germany)		
11,834.41	299.10	2.59%
Hang Seng (Hong Kong)		
23,740.73	379.95	1.63%
Nikkei (Japan)		
19,118.99	77.65	0.41%

Source: Bloomberg

Economic Roundup

Consumer Prices

The Consumer Price Index (CPI) was up 2.5% year-over-year in January, versus up 2.1% year-over-year in December, driven in part by an increase in energy prices. Core CPI (CPI less food and energy) was up 2.3% year-over-year in January, versus up 2.2% year-over-year in December. The Personal Consumption Expenditures (PCE) index was up 1.9% year-over-year in January, versus up 1.6% year-over-year in December. Core PCE (excluding food and energy) was up 1.7% year-over-year in January, unchanged from December. CPI is already trending above 2.0%, and the Fed's primary inflation gauge (PCE) is approaching the Fed's 2.0% target.

Retail Sales

On a year-over-year basis, total retail sales were up 5.6% in January compared with a 4.4% increase in December. On a month-over-month basis, retail sales were up 0.4% in January. Excluding autos and gas, retail sales jumped 0.7% in the month. Auto sales were quite strong in December but declined in January.

Labor Market

The February employment report will be released on March 10, 2017. Nonfarm payrolls were much stronger than expected in January, up 227,000 versus the consensus forecast of 180,000. However, November and December payrolls were revised down by a net 39,000. On both a trailing 3-month and 6-month basis, payrolls increased by an average of 183,000 per month. The unemployment rate inched up to 4.8% from 4.7%, but the participation rate also increased to 62.9% from 62.7%. A broader measure of unemployment called the U-6, which includes those who are marginally attached to the labor force and employed part time for economic reasons, increased to 9.4% in January from 9.2% in December. Wage growth was disappointing, rising just 0.1% in January, versus expectations for a 0.3% increase. On a year-over-year basis, wages were up 2.5% in January, vs. 2.8% in December.

Housing Starts

Total housing starts fell 2.6% in January, following an 11.3% increase in December. Single-family starts rose 1.9% in January, but multi-family starts declined 10.2%. However, on a year-over-year basis, both single- and multi-family starts have increased. Permits were stronger than expected in January, up 4.6%.

Credit Spreads Tightened in February

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top rated commercial paper	0.23	0.32	(0.09)
2-year A corporate note	0.49	0.58	(0.09)
5-year A corporate note	0.61	0.69	(0.08)
5-year Agency note	0.06	0.10	(0.04)

Source: Bloomberg Data as of 2/28/2017

Economic Data Points to Continued Slow Growth

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(48.5) $Bln JAN 17	(44.3) $Bln DEC 16	(43.4) $Bln JAN 16
GDP	1.9% DEC 16	3.5% SEP 16	0.9% DEC 15
Unemployment Rate	4.8% JAN 17	4.7% DEC 16	4.9% JAN 16
Prime Rate	3.75% FEB 17	3.75% JAN 17	3.50% FEB 16
CRB Index	190.62 FEB 17	192.03 JAN 17	163.21 FEB 16
Oil (West Texas Int.)	$54.01 FEB 17	$52.81 JAN 17	$33.75 FEB 16
Consumer Price Index (y/o/y)	2.5% JAN 17	2.1% DEC 16	1.4% JAN 16
Producer Price Index (y/o/y)	3.0% JAN 17	1.9% DEC 16	(1.2%) JAN 16
Dollar/Euro	1.06 FEB 17	1.08 JAN 17	1.09 FEB 16

Source: Bloomberg

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