CHANDLER ASSET MANAGEMENT

BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

JULY 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.

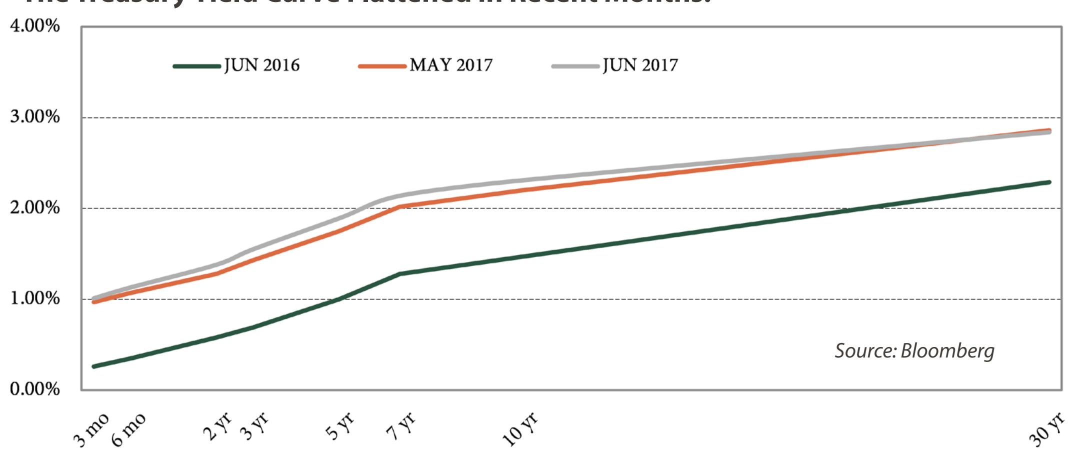
Market Summary

The Federal Open Market Committee (FOMC) raised the fed funds target rate by 25 basis points to a range of 1.00%-1.25% at the June 13-14 meeting. However, the FOMC statement indicated that the stance of monetary policy remains accommodative. The FOMC also noted that economic activity has been rising moderately and job gains have been solid, but inflation has recently declined. Nevertheless, the FOMC expects inflation to stabilize around 2.0% over the medium term. The Committee expects to begin trimming the Fed's balance sheet later this year. The Fed's updated Summary of Economic Projections reflects downward revisions to the Fed's median unemployment rate projections for this year and future years, as well as a downward revision to the Fed's median 2017 inflation forecast. The updated projections suggest that the Fed anticipates the labor market to tighten further over the coming years without much impact on inflation. The Fed still expects the fed funds rate to reach 1.4% by the end of this year (which implies one more rate hike before year-end) and 3.0% over the longer-run.

Domestic economic data remains indicative of slow growth. The economy is likely at or near full employment, consumer confidence is strong, manufacturing indicators are indicative of modest expansion, and housing trends remain favorable. Looking ahead, a potential boost in fiscal stimulus could provide a further tailwind to economic growth. GDP grew by 1.4% in the first quarter, following growth of 2.1% in the fourth quarter. We expect modest economic growth of about 2.0%-2.5% for the full year 2017.

Treasury yields increased modestly in June, led by the 5-year note. The 2-year and 10-year Treasury yields both increased by ten basis points month-over-month, while the 5-year Treasury yield increased 14 basis points. The move higher in domestic yields occurred late in the month, coinciding with hawkish comments from ECB President Draghi. His comments also provided a catalyst for sovereign yields in Germany and Japan to move higher.

The Treasury Yield Curve Flattened in Recent Months:



Over the past three months the yield curve flattened. The spread between 2-year and 10-year Treasury yields narrowed to 92 basis points as of June 30, compared to 114 basis points on March 31. On a year-over-year basis, Treasury yields have increased meaningfully, with the 2-year Treasury yield up 80 basis points and the 10-year Treasury yield up 83 basis points. The Federal Reserve has raised the fed funds target rate by 25 basis points three times in the past year.

TREASURY YIELDS	Trend (▲/▼)	6/30/2017	5/31/2017	Change
3-Month	▲	1.01	0.97	0.04
2-Year	▲	1.38	1.28	0.10
3-Year	▲	1.55	1.43	0.12
5-Year	▲	1.89	1.75	0.14
7-Year	▲	2.14	2.02	0.12
10-Year	▲	2.31	2.20	0.11
30-Year	▼	2.84	2.86	(0.02)

Source: Bloomberg

Market Data

World Indices
data as of 6/30/2017

	Diff (5/31/17)	% Change
S&P 500		
2,423.41	11.61	0.48%
NASDAQ		
6,140.42	(58.10)	(0.94%)
DOW JONES		
21,349.63	340.98	1.62%
FTSE (UK)		
7,312.72	(207.23)	(2.76%)
DAX (Germany)		
12,325.12	(289.94)	(2.30%)
Hang Seng (Hong Kong)		
25,764.58	103.93	0.41%
Nikkei (Japan)		
20,033.43	382.86	1.95%

Source: Bloomberg

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Economic Roundup

Consumer Prices

The Consumer Price Index (CPI) was up 1.9% year-over-year in May, versus up 2.2% year-over-year in April. Core CPI (CPI less food and energy) was up just 1.7% year-over-year in May, versus up 1.9% year-over-year in April. The Personal Consumption Expenditures (PCE) index was up 1.4% year-over-year in May, versus up 1.7% year-over-year in April. Core PCE (excluding food and energy) was also up just 1.4% year-over-year in May, versus up 1.5% year-over-year in April. Core CPI is has fallen back below the Fed's 2.0% target, and the Fed's primary inflation gauge (PCE) also remains below the target.

Retail Sales

On a year-over-year basis, total retail sales were up 3.8% in May compared with a 4.6% increase in April. On a month-over-month basis, retail sales declined 0.3% in May, below expectations for a 0.1% increase, following a 0.4% increase in April. Excluding autos and gas, retail sales were flat in May, following a 0.5% gain in April. Overall, consumer spending trends remain soft.

Labor Market

Job growth was stronger than expected in June but wages remained lackluster. Nonfarm payrolls increased by 222,000 versus the consensus forecast of 178,000. In addition, April and May payrolls were revised up by 47,000 in total. The average increase in monthly payrolls was 194,000 during the second quarter, up from 166,000 per month during the first quarter. The unemployment rate ticked up to 4.4% in June from 4.3% in May, but the labor participation rate also edged up to 62.8% 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 8.6% in June from 8.4% in May, however this compares to 9.6% in June 2016. Wage growth rose just 0.2% in June, following a downwardly revised gain of 0.1% in May. On a year-over-year basis, wages were up 2.5% in June, versus 2.4% in May.

Housing Starts

Total housing starts fell 5.5% in May, following a 2.8% decrease in April, missing expectations. Single-family starts declined 3.9% in May, and multi-family starts fell 9.7%. Permits were also weaker than expected in May, down 4.9%.

Credit Spreads Tightened Further in June

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top rated commercial paper	0.18	0.03	0.15
2-year A corporate note	0.50	0.53	(0.03)
5-year A corporate note	0.63	0.69	(0.06)
5-year Agency note	0.07	0.12	(0.05)

Source: Bloomberg Data as of 6/30/2017

Economic Data Remains Indicative of Slow Growth

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(46.5) \$Bln MAY 17	(47.6) \$Bln APR 17	(41.5) \$Bln MAY 16
GDP	1.4% MAR 17	2.1% DEC 16	0.8% MAR 16
Unemployment Rate	4.4% JUN 17	4.3% MAY 17	4.9% JUN 16
Prime Rate	4.25% JUN 17	4.0% MAY 17	3.5% JUN 16
CRB Index	174.78 JUN 17	179.77 MAY 17	192.57 JUN 16
Oil (West Texas Int.)	\$46.04 JUN 17	\$48.32 MAY 17	\$48.33 JUN 16
Consumer Price Index (y/o/y)	1.9% MAY 17	2.2% APR 17	1.0% MAY 16
Producer Price Index (y/o/y)	2.6% MAY 17	3.9% APR 17	(2.2%) MAY 16
Dollar/Euro	1.14 JUN 17	1.12 MAY 17	1.11 JUN 16

Source: Bloomberg