BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

OCTOBER 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.

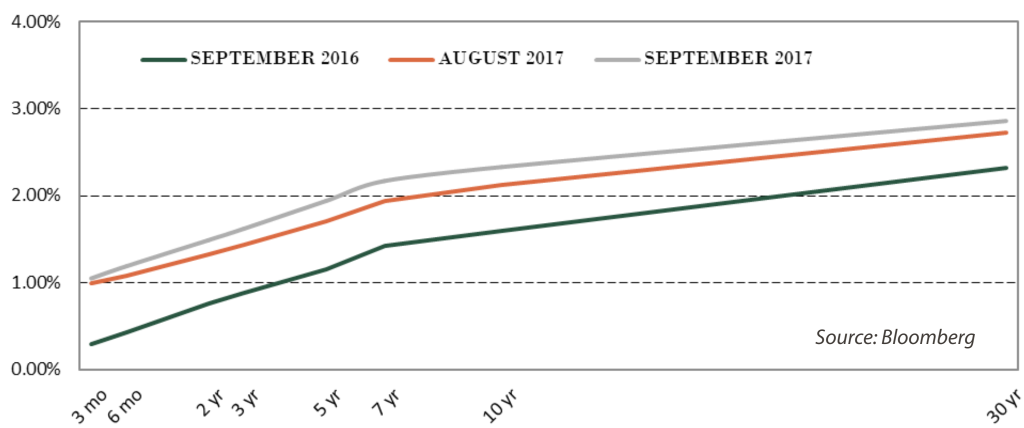
Market Summary

The Federal Open Market Committee (FOMC) left the fed funds target rate unchanged at a range of 1.00%-1.25% at the September 19-20 meeting. However, the Committee began its balance sheet normalization program this month. The process of unwinding the Fed's $4.5 trillion balance sheet is beginning gradually by allowing $6 billion per month in Treasury securities and $4 billion per month in mortgage-backed and agency securities to roll off the balance sheet. Over time, the amounts will slowly increase to $30 billion per month in Treasury securities and $20 billion per month in mortgage-backed and agency securities. The Fed's updated economic projections still indicate one more rate hike before year-end is expected. However, the Fed lowered its median longer-run fed funds rate projection to 2.8% from 3.0%. The Fed's other economic projections were little changed in September, although the median 2018 inflation forecast was lowered slightly, suggesting that the Committee now thinks inflation may remain below the Fed's 2.0% target until 2019.

GDP grew by 3.1% in the second quarter, following growth of 1.2% in the first quarter. The consensus forecast currently calls for GDP growth of about 2.6% in the third quarter and 2.4% in the current quarter. We believe economists may trim their estimates for third quarter GDP growth, to reflect disruptions caused by Hurricanes Harvey and Irma. Tax reform or fiscal stimulus may ultimately help fuel stronger economic growth, but the timing and magnitude of such programs remains uncertain.

The Treasury yield curve steepened in September, partially reversing some of the curve flattening that has happened year-to-date. The 2-year Treasury yield increased 16 basis points in September to 1.48% and the 10-year Treasury yield increased about 22 basis points to 2.33%. On a year-to-date basis, the 2-year Treasury yield increased 29 basis points and the 10-year Treasury yield declined 11 basis points. Since the beginning of this year, we believe market participants have grown skeptical that the Trump administration will deliver on many of their legislative objectives. However, the administration recently outlined a general framework for tax reform, sparking some renewed optimism that changes to the tax code may help boost economic growth.

The Treasury Yield Curve Flattened This Year:



The yield curve steepened in September but has flattened year-to-date. The spread between 2-year and 10-year Treasury yields was just 85 basis points at the end of September, compared to 126 at the end of 2016. In the three months ending in September, the 2-year Treasury yield increased about ten basis points while the 10-year Treasury yield increased just three basis points. Immediately following the US Presidential election last fall, the Treasury yield curve steepened, but much of that has since reversed.

TREASURY YIELDS	Trend (▲/▼)	9/30/2017	8/31/2017	Change
3-Month	▲	1.05	0.99	0.06
2-Year	▲	1.49	1.33	0.16
3-Year	▲	1.62	1.43	0.19
5-Year	▲	1.94	1.70	0.24
7-Year	▲	2.17	1.94	0.23
10-Year	▲	2.33	2.12	0.21
30-Year	▲	2.86	2.73	0.13

Source: Bloomberg

Market Data

World Indices
data as of 9/30/2017

	Diff (8/31/17)	% Change
S&P 500		
2,519.36	47.71	1.93%
NASDAQ		
6,495.96	67.30	1.05%
DOW JONES		
22,405.09	456.99	2.08%
FTSE (UK)		
7,372.76	(57.86)	(0.78%)
DAX (Germany)		
12,828.86	773.02	6.41%
Hang Seng (Hong Kong)		
27,554.30	(416.00)	(1.49%)
Nikkei (Japan)		
20,356.28	710.04	3.61%

Source: Bloomberg

Economic Roundup

Consumer Prices

The Consumer Price Index (CPI) was up 1.9% year-over-year in August, versus up 1.7% year-over-year in July. Core CPI (CPI less food and energy) was up just 1.7% year-over-year in August, unchanged from the prior month. The Personal Consumption Expenditures (PCE) index was up 1.4% year-over-year in August, unchanged from June or July. Core PCE (excluding food and energy) was up just 1.3% year-over-year in August, versus up 1.4% year-over-year in July. Inflation remains below the Fed's 2.0% target.

Retail Sales

On a year-over-year basis, total retail sales were up 3.2% in August compared with a 3.5% increase in July. On a month-over-month basis, retail sales declined 0.2% in August, below expectations for a 0.1% increase. Excluding autos and gas, retail sales fell 0.1% in August. Overall, August retail sales were lackluster. Although August results may have been negatively impacted by Hurricane Harvey, the retail sales figures for July were also revised down.

Labor Market

U.S. payrolls declined 33,000 in September, well below the +80,000 consensus estimate. However, September payrolls were likely significantly distorted by the hurricanes. The unemployment rate decreased to 4.2% in September from 4.4% in August, and the labor participation rate increased to 63.1% from 62.9%. 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, declined to 8.3% from 8.6%. Wages jumped 0.5% in September. On a year-over-year basis wages were up 2.9% in September, versus up 2.7% year-over-year in August.

Housing Starts

Total housing starts fell slightly in August but were still stronger than expected. Single-family starts increased 1.6% in August, partially offsetting a 6.5% decline in multi-family starts. Permits were stronger than expected in August, up 5.7%, driven by a 19.6% surge in multi-family permits. Overall, the August housing starts report was favorable, particularly considering it includes some effects from Hurricane Harvey.

Credit Spreads Tightened in September

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top rated commercial paper	0.18	0.24	(0.06)
2-year A corporate note	0.42	0.47	(0.05)
5-year A corporate note	0.57	0.65	(0.08)
5-year Agency note	0.09	0.11	(0.02)

Source: Bloomberg Data as of 9/30/2017

Economic Data Remains Indicative of Slow Growth

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(42.4) $Bln AUG 17	(43.6) $Bln JUL 17	(41.1) $Bln AUG 16
GDP	3.1% JUN 17	1.2% MAR 17	2.2% JUN 16
Unemployment Rate	4.2% SEP 17	4.4% AUG 17	4.9% SEP 16
Prime Rate	4.25% SEP 17	4.25% AUG 17	3.5% SEP 16
CRB Index	183.09 SEP 17	180.86 AUG 17	186.31 SEP 16
Oil (West Texas Int.)	$51.67 SEP 17	$47.23 AUG 17	$48.24 SEP 16
Consumer Price Index (y/o/y)	1.9% AUG 17	1.7% JUL 17	1.1% AUG 16
Producer Price Index (y/o/y)	2.9% AUG 17	2.2% JUL 17	(1.9%) AUG 16
Dollar/Euro	1.18 SEP 17	1.19 AUG 17	1.12 SEP 16

Source: Bloomberg

CHANDLER ASSET MANAGEMENT
Toll Free: 800.317.4747
info@chandlerasset.com
chandlerasset.com