CHANDLER ASSET MANAGEMENT

BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

NOVEMBER 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

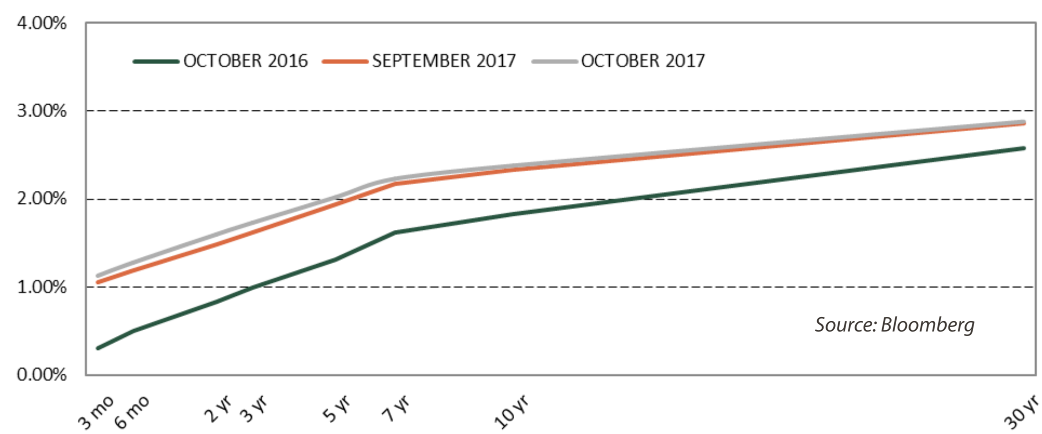
The Federal Open Market Committee (FOMC) left the fed funds target rate unchanged at the November 1 meeting, as expected. The vote was unanimous. The Fed said economic activity had been rising "at a solid rate despite hurricane-related disruptions." However, inflation measures remain low. Market participants are expecting a 25 basis point rate hike at the next meeting on December 12-13. If the Fed proceeds with another rate hike in December, we think it is unlikely that the vote would be unanimous given the flatness of the Treasury yield curve, the persistent weakness in inflation and wage growth, and ongoing monetary policy accommodation among other global central banks. Nevertheless, we believe the Fed will remain on a path toward policy normalization in 2018.

President Trump nominated Jerome Powell to be the next Chair of the Federal Reserve. Powell has served on the Board of Governors and been a voting member of the FOMC since 2012, and is expected to provide continuity to the existing plan of gradual monetary policy normalization. However, there are still multiple vacancies on the Board and there will be a lot of turnover in the voting membership of the FOMC next year.

GDP grew by 3.0% in the third quarter, following growth of 3.1% in the second quarter and 1.2% in the first quarter. The consensus forecast currently calls for GDP growth of about 2.7% in the current quarter. Overall, recent economic data has been favorable. The economy is at or near full employment, consumer confidence is strong, and leading indicators suggest the economy will continue to grow modestly.

The yield curve has flattened meaningfully this year. The spread between 2-year and 10-year Treasury yields was just 78 basis points at the end of October, compared to 126 at the end of 2016. All else being equal, we believe the Fed's plans to normalize the balance sheet could help promote a steeper yield curve over an intermediate time horizon. Tax reform may also be stimulative to the economy and drive yields at the long end of the curve higher. However, Congress is still negotiating the terms of tax reform and the market impact of the Fed's balance sheet normalization plan will likely remain muted over the near-term.

The Treasury Yield Curve Flattened Further in October:



The Treasury yield curve flattened slightly in October. The 2-year Treasury yield increased about 11 basis points in October to 1.60% and the 10-year Treasury yield increased about five basis points to 2.38%. In the three months ending in October, the 2-year Treasury yield increased about 25 basis points while the 10-year Treasury yield increased about nine basis points.

TREASURY YIELDS	Trend (▲/▼)	10/31/2017	9/30/2017	Change
3-Month	▲	1.13	1.05	0.08
2-Year	▲	1.60	1.49	0.11
3-Year	▲	1.73	1.62	0.11
5-Year	▲	2.02	1.94	0.08
7-Year	▲	2.23	2.17	0.06
10-Year	▲	2.38	2.33	0.05
30-Year	▲	2.88	2.86	0.02

Source: Bloomberg

Market Data

World Indices
data as of 10/31/2017

	Diff (9/30/17)	% Change
S&P 500		
2,575.26	55.90	2.22%
NASDAQ		
6,727.67	231.71	3.57%
DOW JONES		
23,377.24	972.15	4.34%
FTSE (UK)		
7,493.08	120.32	1.63%
DAX (Germany)		
13,299.57	400.71	3.12%
Hang Seng (Hong Kong)		
28,245.54	691.24	2.51%
Nikkei (Japan)		
22,011.61	1,655.33	8.13%

Source: Bloomberg

Economic Roundup

Consumer Prices

The Consumer Price Index (CPI) was up 2.2% year-over-year in September, versus up 1.9% year-over-year in August. Core CPI (CPI less food and energy) was up just 1.7% year-over-year in September. The increase in headline CPI inflation was driven in part by an increase in energy prices following the hurricanes. The Personal Consumption Expenditures (PCE) index was up 1.6% year-over-year in September, versus up 1.4% year-over-year in August. However, Core PCE (excluding food and energy) was unchanged on a year-over-year basis in September, up just 1.3%. Inflation remains below the Fed's 2.0% target.

Retail Sales

On a year-over-year basis, retail sales were up 4.4% in September, versus up 3.5% year-over-year in August. On a month-over-month basis, retail sales increased 1.6% in September, following a 0.1% decline in August. The increase in September retail sales was generally in line with expectations, and was driven in large part by a surge in hurricane-related replacement demand for vehicles as well as a spike in post-hurricane gasoline prices. However, excluding autos and gas, retail sales grew at a moderate pace, up 0.5% in September, month-over-month.

Labor Market

U.S. payrolls rose by 261,000 in October, following an increase of just 18,000 in September. The post-hurricane rebound in payroll growth was weaker than expected in October. The shortfall was somewhat offset by 90,000 in upward revisions to the two prior months. On a trailing 6-month basis (which smooths out some of the hurricane-related volatility), payrolls increased by an average of 163,000 per month. The unemployment rate declined to 4.1% in October from 4.2% in September, but the labor participation rate declined to 62.7% from 63.1%. 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 7.9% in October from 8.3% in September. Wages were flat in October and were up just 2.4% on a year-over-year basis. This compares to a 2.9% year-over-year increase in September.

Housing Starts

Total housing starts were weaker than expected in September, down 4.7%. Single-family starts decreased 4.6% in September, while multi-family starts declined 5.1%. Permits were also slightly weaker than expected in September, down 4.5%, due to weakness in multi-family permits. Overall, September housing starts were soft, but activity may rebound in the fourth quarter as hurricane-related rebuilding efforts intensify.

Credit Spreads Tightened in October

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top rated commercial paper	0.13	0.18	(0.05)
2-year A corporate note	0.36	0.42	(0.06)
5-year A corporate note	0.52	0.57	(0.05)
5-year Agency note	0.08	0.09	(0.01)

Source: Bloomberg Data as of 10/31/2017

Economic Data Points to Slow Growth, Despite Hurricane-Related Distortions

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(43.5) $Bln SEP 17	(42.8) $Bln AUG 17	(38.5) $Bln SEP 16
GDP	3.0% SEP 17	3.1% JUN 17	2.8% SEP 16
Unemployment Rate	4.1% OCT 17	4.2% SEP 17	4.8% OCT 16
Prime Rate	4.25% OCT 17	4.25% SEP 17	3.5% OCT 16
CRB Index	187.56 OCT 17	183.09 SEP 17	186.28 OCT 16
Oil (West Texas Int.)	$54.38 OCT 17	$51.67 SEP 17	$46.86 OCT 16
Consumer Price Index (y/o/y)	2.2% SEP 17	1.9% AUG 17	1.5% SEP 16
Producer Price Index (y/o/y)	3.3% SEP 17	2.9% AUG 17	(0.1%) SEP 16
Dollar/Euro	1.16 OCT 17	1.18 SEP 17	1.10 OCT 16

Source: Bloomberg

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