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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.

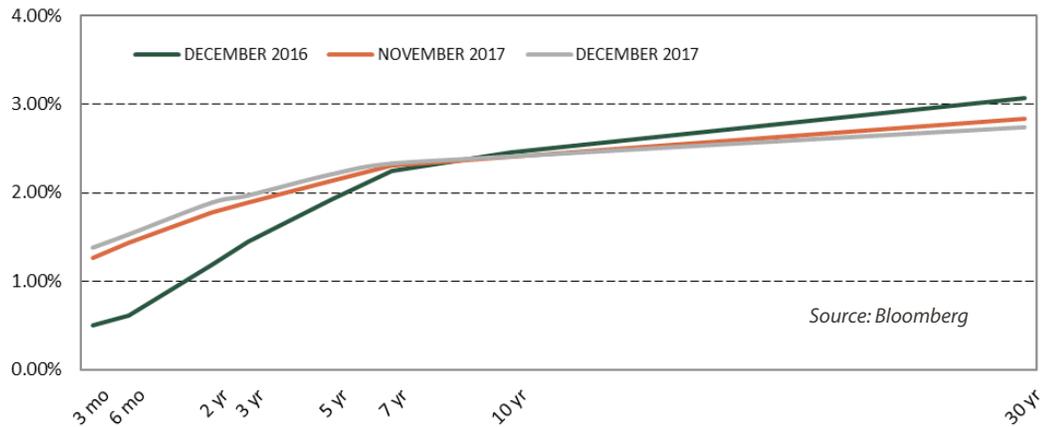
## Market Summary

The yield curve flattened meaningfully in 2017, with the 2-year/10-year Treasury yield spread narrowing from 126 basis points the end of 2016 to as low as 52 basis points at the end of December, the tightest spread since October 2007. In December, the 2-year Treasury yield increased about ten basis points to 1.88% and the 10-year Treasury yield was essentially unchanged. During 2017, the Federal Reserve raised the fed funds rate three times by a total of 75 basis points, which largely fueled the increase in shorter rates. However, inflation expectations were muted, which kept a lid on longer-term rates. All else being equal, we believe the Fed's ongoing efforts to normalize the balance sheet should help promote a steeper yield curve, but we don't expect the impact of this to be reflected in the market until later this year. We also believe tax reform is likely to provide a tailwind to economic growth and help drive yields at the long end of the curve higher. Global demand for Treasuries will also continue to influence yields.

The Federal Open Market Committee's (FOMC) economic projections indicate the Fed plans to hike the fed funds rate three times this year to a median level of 2.1%. We believe the rotation of new voting members into the FOMC this year, as well as a new Fed Chairman, may make for a more hawkish FOMC this year. Assuming inflation remains contained below 2.0% and the US dollar does not materially appreciate, we think three rate hikes are likely this year. While we expect the Fed to remain on a path toward monetary policy normalization, we continue to believe that the Fed's terminal rate forecast of 2.8% is too high, and believe the long-run rate is probably closer to 2.5%. As such, we see little room for additional rate hikes beyond this year, unless there is a significant pick-up in economic growth and inflation.

We are forecasting GDP growth of about 2.5% in 2018, which is in line with the Fed's forecast and the market consensus. This would equate to a slight increase over the 2017 GDP growth consensus estimate of 2.3%. Overall, economic data was quite favorable heading into 2018, with the exception of still-sluggish inflation readings. The economy is at or near full employment, consumer confidence is strong, and leading indicators suggest the economy will continue to grow modestly.

### The Treasury Yield Curve Flattened Further in December:



The Treasury yield curve continued to flatten in December. The 2-year Treasury yield increased about ten basis points in December to 1.88% and the 10-year Treasury yield was essentially unchanged.

| TREASURY YIELDS | Trend (▲/▼) | 12/31/2017 | 11/30/2017 | Change |
|-----------------|-------------|------------|------------|--------|
| 3-Month         | ▲           | 1.38       | 1.26       | 0.12   |
| 2-Year          | ▲           | 1.89       | 1.78       | 0.11   |
| 3-Year          | ▲           | 1.97       | 1.89       | 0.08   |
| 5-Year          | ▲           | 2.21       | 2.14       | 0.07   |
| 7-Year          | ▲           | 2.33       | 2.31       | 0.02   |
| 10-Year         | ▲           | 2.41       | 2.41       | 0.00   |
| 30-Year         | ▼           | 2.74       | 2.83       | (0.09) |

Source: Bloomberg

## Economic Roundup

### Consumer Prices

The Consumer Price Index (CPI) was up 2.1% year-over-year in December, versus up 2.2% year-over-year in November. Core CPI (CPI less food and energy) was up 1.8% year-over-year in December, versus up 1.7% year-over-year in November. Core CPI remains soft but did move higher. The Personal Consumption Expenditures (PCE) index was up 1.8% year-over-year in November, versus up 1.6% year-over-year in October. However, Core PCE (excluding food and energy) was up just 1.5% on a year-over-year basis in November. PCE inflation remains well below the Fed's 2.0% target.

### Retail Sales

On a year-over-year basis, retail sales were up 5.4% in December, versus up 6.0% year-over-year in November. On a month-over-month basis, retail sales increased 0.4% in December (slightly below expectations), following a strong 0.9% increase in November. Excluding autos and gas, the month-over-month figure was up 0.4% in December as well. Overall, retail sales for the last two months of the year combined are indicative of solid consumer spending trends.

### Labor Market

U.S. nonfarm payrolls rose by 148,000 in December, below the consensus forecast of 191,000 but still enough to absorb new entrants into the labor market. October and November payrolls were revised down by a net total of 9,000. Nevertheless, on a trailing 3-month and 6-month basis, payrolls increased by an average of 204,000 and 166,000 per month, respectively. The unemployment rate and the labor participation rate were unchanged in December at 4.1% and 62.7%, respectively. 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, edged up to 8.1% in December from 8.0% in November and 7.9% in October. Wages rose 0.3% in December, following a downwardly revised 0.1% increase in November. Wages were up 2.5% on a year-over-year basis in December, in line with expectations.

### Housing Starts

Total housing starts were stronger than expected in November, up 3.3%. Single-family starts increased 5.3% in November, while multi-family starts were down slightly. Permits were also better than than expected in November.

### Credit Spreads Tightened Slightly in December

| CREDIT SPREADS                     | Spread to Treasuries (%) | One Month Ago (%) | Change |
|------------------------------------|--------------------------|-------------------|--------|
| 3-month top rated commercial paper | 0.14                     | 0.08              | 0.06   |
| 2-year A corporate note            | 0.37                     | 0.39              | (0.02) |
| 5-year A corporate note            | 0.48                     | 0.53              | (0.05) |
| 5-year Agency note                 | 0.07                     | 0.07              | 0.00   |

Source: Bloomberg

Data as of 12/31/2017

### Economic Data Points to Ongoing Growth

| ECONOMIC INDICATOR           | Current Release     | Prior Release       | One Year Ago        |
|------------------------------|---------------------|---------------------|---------------------|
| Trade Balance                | (50.5) \$Bln NOV 17 | (48.9) \$Bln OCT 17 | (46.4) \$Bln NOV 16 |
| GDP                          | 3.2% SEP 17         | 3.1% JUN 17         | 2.8% SEP 16         |
| Unemployment Rate            | 4.1% DEC 17         | 4.1% NOV 17         | 4.7% DEC 16         |
| Prime Rate                   | 4.50% DEC 17        | 4.25% NOV 17        | 3.75% DEC 16        |
| CRB Index                    | 193.86 DEC 17       | 189.17 NOV 17       | 192.51 DEC 16       |
| Oil (West Texas Int.)        | \$60.42 DEC 17      | \$57.40 NOV 17      | \$53.72 DEC 16      |
| Consumer Price Index (y/o/y) | 2.1% DEC 17         | 2.2% NOV 17         | 2.1% DEC 16         |
| Producer Price Index (y/o/y) | 3.3% DEC 17         | 4.3% NOV 17         | 1.9% DEC 16         |
| Dollar/Euro                  | 1.20 DEC 17         | 1.19 NOV 17         | 1.05 DEC 16         |

Source: Bloomberg

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## Market Data

### World Indices

data as of 12/31/2017

|                       | Diff<br>(11/30/17) | %<br>Change |
|-----------------------|--------------------|-------------|
| S&P 500               |                    |             |
| 2,673.61              | 26.03              | 0.98%       |
| NASDAQ                |                    |             |
| 6,903.39              | 29.42              | 0.43%       |
| DOW JONES             |                    |             |
| 24,719.22             | 446.87             | 1.84%       |
| FTSE (UK)             |                    |             |
| 7,687.77              | 361.10             | 4.93%       |
| DAX (Germany)         |                    |             |
| 12,917.64             | (106.34)           | (0.82%)     |
| Hang Seng (Hong Kong) |                    |             |
| 29,919.15             | 741.80             | 2.54%       |
| Nikkei (Japan)        |                    |             |
| 22,764.94             | 39.98              | 0.18%       |

Source: Bloomberg



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