CHANDLER ASSET MANAGEMENT

BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

AUGUST 2019

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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.

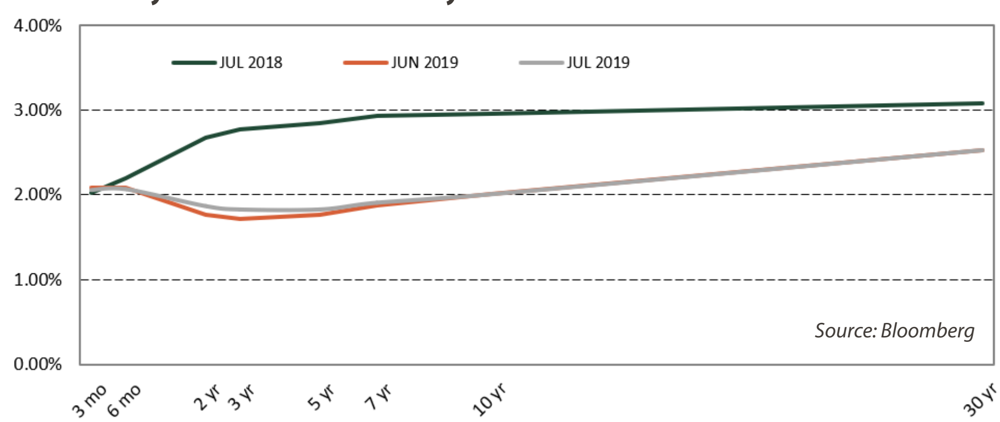
Market Summary

In our view, US domestic economic data remains consistent with a slow growth environment but downside risks to the outlook have increased. The US labor market is strong, wages are growing modestly, and inflation remains contained. However, headwinds from trade disputes, slowing global economic growth, an uncertain outlook for Brexit, and geopolitical tensions have increased. The trajectory of economic growth is likely to hinge on the outcome of ongoing trade negotiations as well as policy action by the major global central banks. We believe there is a high level of political pressure to make progress toward a trade agreement with China before the election cycle heats up. We also believe a dovish collective stance by major global central banks should help to combat the headwinds to global economic growth.

The Federal Open Market Committee (FOMC) cut the target fed funds rate by 25 basis points on July 31 to a range of 2.00%-2.25%, as widely expected. The Fed also decided to end their balance sheet normalization program two months early (as of August 1st). There were two dissenting votes from policymakers who preferred to keep the fed funds rate unchanged. Fed Chair Powell indicated that the impetus for the rate cut was threefold; a decline in the neutral fed funds rate, global economic weakness, and the desire to reset inflation expectations. Powell referred to the cut as a "mid-cycle adjustment to policy" and said that he did not believe it was the beginning of a long rate-cutting cycle. We believe Fed Chair Powell left the door open for further monetary policy accommodation but tempered expectations for a series of future rate cuts. We believe another rate cut before year-end is possible, particularly in light of ongoing global trade tensions and an uncertain outlook for Brexit.

Treasury yields were little changed at July month-end. The 3-month T-bill yield was down about three basis points to 2.06%, the 2-year Treasury yield was up 12 basis points to 1.87%, and the 10-year Treasury yield was nearly unchanged at 2.01%. An inversion of the yield curve in which the 10-year Treasury yield is lower than the 3-month T-bill yield is generally viewed as a powerful predictive signal of an upcoming recession. However, we believe increased short-term Treasury issuance to fund the deficit, and negative long-term sovereign bond yields in other countries have distorted the US Treasury yield curve. Sovereign 10-year bond yields around the world have been under pressure and the yields on both the 10-year German Bund and 10-year Japanese Government Bond were negative at July month-end.

The Treasury Yield Curve is Partially Inverted



The shape of the Treasury yield curve has changed significantly on a year-over-year basis. As of month-end in July, the 3-month T-bill yield was up about four basis points, the 2-Year Treasury yield was down nearly 80 basis points, and the 10-Year Treasury yield was down nearly 95 basis points, year-over-year. The current shape of the yield curve implies that market participants are pricing-in additional rate cuts. We believe the year-over-year decline in long-term Treasury yields reflects a high level of market participants' nervousness about the outlook for global economic growth and a decline in global inflation expectations.

TREASURY YIELDS	Trend (▲/▼)	7/31/2019	6/30/2019	Change
3-Month	▼	2.06	2.09	(0.03)
2-Year	▲	1.87	1.76	0.11
3-Year	▲	1.83	1.71	0.12
5-Year	▲	1.83	1.77	0.06
7-Year	▲	1.91	1.88	0.03
10-Year	-	2.01	2.01	0.00
30-Year	-	2.53	2.53	0.00

Source: Bloomberg

Market Data

World Indices
data as of 7/31/2019

		Diff (6/30/19)	% Change
S&P 500	**2,980.38**	38.62	1.31%
NASDAQ	**8,175.42**	169.18	2.11%
DOW JONES	**26,864.27**	264.31	0.99%
FTSE (UK)	**7,586.78**	161.15	2.17%
DAX (Germany)	**12,189.04**	209.76	1.69%
Hang Seng (Hong Kong)	**27,777.75**	764.87	2.68%
Nikkei (Japan)	**21,521.43**	245.61	1.15%

Source: Bloomberg

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Economic Roundup

Consumer Prices

The Consumer Price Index (CPI) was up just 1.6% year-over-year in June, versus up 1.8% year-over-year in May. Core CPI (CPI less food and energy) was up 2.1% year-over-year in June, versus up 2.0% year-over-year in May. The Personal Consumption Expenditures (PCE) index was up 1.4% year-over-year in June, unchanged from May. Core PCE, which is the Fed's primary inflation gauge, was up 1.6% year-over-year in June, up from 1.5% year-over-year in May. However, core PCE remains below the Fed's 2.0% inflation target.

Retail Sales

Retail sales in June were stronger than expected, up 0.4% in the month versus expectations of 0.1%, following an increase of 0.4% in May. Excluding autos and gas, retail sales were even stronger in June, up 0.7% (outpacing expectations of 0.4%). On a year-over-year basis, total retail sales were up 3.4% year-over-year in June, versus 2.9% year-over-year in May.

Labor Market

U.S. nonfarm payrolls rose by 164,000 in July, in line with expectations. However, May and June payrolls were revised down by a total of 41,000. On a trailing 3-month and 6-month average basis, payrolls increased an average of about 140,000 per month, which represents a decline from the 12-month average of 187,000. The unemployment rate was unchanged at 3.7% in July, despite an increase in the participation rate to 63.0% from 62.9% in June. 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 7.0% in July (the lowest level since December 2000) from 7.2% in June. Wages rose 0.3% in July (slightly above expectations), following an upwardly revised 0.3% increase in June. On a year-over-year basis, wages were up 3.2% in July, versus up 3.1% in June.

Housing Starts

Housing starts were nearly in line with expectations in June, down 0.9% month-over-month to a 1.253 million annualized rate. Multi-family starts fell 9.2% to an annualized rate of 406,000, while single-family starts rose 3.5% to an annualized rate of 847,000. Total housing starts were up 6.2% year-over-year in June, driven by growth in multi-family starts.

Credit Spreads Tightened in July

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top rated commercial paper	0.10	0.10	0.00
2-year A corporate note	0.42	0.51	(0.09)
5-year A corporate note	0.61	0.65	(0.04)
5-year Agency note	0.10	0.12	(0.02)

Source: Bloomberg Data as of 7/31/2019

Economic Data Remains Consistent with Slow Growth

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(55.2) $Bln JUN 19	(55.3) $Bln MAY 19	(47.4) $Bln JUN 18
GDP	2.1% JUN 19	3.1% MAR 19	3.5% JUN 18
Unemployment Rate	3.7% JUL 19	3.7% JUN 19	3.9% JUL 18
Prime Rate	5.50% JUL 19	5.50% JUN 19	5.00% JUL 18
CRB Index	178.53 JUL 19	181.04 JUN 19	194.53 JUL 18
Oil (West Texas Int.)	$58.58 JUL 19	$58.47 JUN 19	$68.76 JUL 18
Consumer Price Index (y/o/y)	1.6% JUN 19	1.8% MAY 19	2.9% JUN 18
Producer Price Index (y/o/y)	0.4% JUN 19	1.0% MAY 19	4.1% JUN 18
Dollar/Euro	1.11 JUL 19	1.14 JUN 19	1.17 JUL 18

Source: Bloomberg