CHANDLER ASSET MANAGEMENT

BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

OCTOBER 2019

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Since 1988, Chandler Asset Management has specialized in providing fixed income investment solutions to risk-averse public agencies and institutions. Chandler's mission is to provide fully customizable, client-centered portfolio management that preserves principal, mitigates risk and generates income in our clients' portfolios.

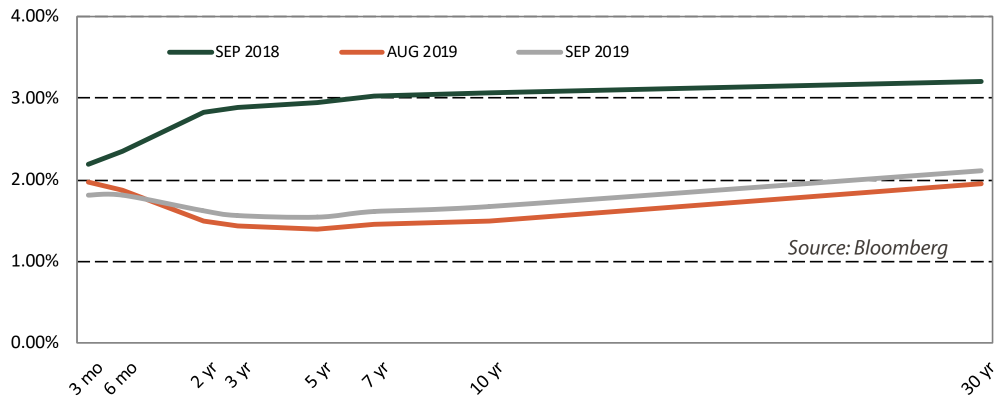
Market Summary

Labor market and consumer fundamentals remain favorable, but manufacturing data continue to disappoint. We believe economic growth has slowed from earlier this year and downside risks to the outlook remain elevated. The US economy continues to face headwinds from trade disputes, slowing global economic growth, and an uncertain outlook for Brexit. However, we believe accommodative US monetary policy and a collective dovish stance by all of the major global central banks should help to combat the headwinds. We also believe the Trump administration faces significant political pressure to make progress toward a trade agreement with China as we head into an election year.

The Federal Open Market Committee (FOMC) lowered the target fed funds rate by 25 basis points in September (for the second time this year) to a range of 1.75%-2.00%. There were three dissenting votes; one policymaker favored a 50-basis point rate cut, and two policymakers favored leaving the fed funds rate unchanged. According to the Fed's dot plot, only seven out of 17 policymakers are anticipating another rate cut before year-end. Although there is a growing disparity among policymakers about the appropriate path of monetary policy, Fed Chair Powell's press conference suggested the Fed will be flexible and data dependent. Powell indicated more rate cuts may be appropriate if the economy slows further, but the Fed is not on a preset course. We continue to believe the FOMC is likely to cut the fed funds target rate again before year-end, in the absence of a trade resolution or meaningful improvement in market-based measures of inflation. The next FOMC meeting is scheduled for October 29-30.

The Treasury yield curve steepened modestly in September, although the curve remains partially inverted. The 3-month T-bill yield declined nearly 17 basis points to 1.81%, the 2-year Treasury yield increased nearly twelve basis points to 1.62%, and the 10-year Treasury yield increased about 17 basis points to 1.67%. 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 sovereign bond yields in other countries may be distorting the US Treasury yield curve. German sovereign bond yields (from 1-month out to 30-years) remained negative at September month-end.

The Treasury Yield Curve Remains Partially Inverted



The shape of the Treasury yield curve has changed significantly on a year-over-year basis. As of September month-end, the 3-month T-bill yield was down 39 basis points, the 2-Year Treasury yield was down nearly 120 basis points, and the 10-Year Treasury yield was down nearly 140 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 (▲/▼)	9/30/2019	8/31/2019	Change
3-Month	▼	1.81	1.98	(0.17)
2-Year	▲	1.62	1.50	0.12
3-Year	▲	1.56	1.43	0.13
5-Year	▲	1.54	1.39	0.15
7-Year	▲	1.61	1.45	0.16
10-Year	▲	1.67	1.50	0.17
30-Year	▲	2.11	1.96	0.15

Source: Bloomberg

Market Data

World Indices
data as of 9/30/2019

	Diff (8/31/19)	% Change
S&P 500		
2,976.74	50.28	1.72%
NASDAQ		
7,999.34	36.46	0.46%
DOW JONES		
26,916.83	513.55	1.95%
FTSE (UK)		
7,408.21	201.03	2.79%
DAX (Germany)		
12,428.08	488.80	4.09%
Hang Seng (Hong Kong)		
26,092.27	367.54	1.43%
Nikkei (Japan)		
21,755.84	1,051.47	5.08%

Source: Bloomberg

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

Economic Roundup

Consumer Prices

The Consumer Price Index (CPI) was up 1.7% year-over-year in August, versus up 1.8% year-over-year in July. Core CPI (CPI less food and energy) was up 2.4% year-over-year in August, versus up 2.2% year-over-year in July. The Personal Consumption Expenditures (PCE) index was up 1.4% year-over-year in August, unchanged from July. Core PCE, which is the Fed's primary inflation gauge, was up 1.8% year-over-year in August versus 1.7% year-over-year in July. Core PCE remains below the Fed's 2.0% inflation target.

Retail Sales

Retail sales in August were moderately above consensus expectations, coming in at 0.4% compared to the 0.2% estimate. Excluding auto and gas, retail sales were up 0.1% compared to expectations for a 0.2% increase. On a year-over-year basis, retail sales increased by 4.1%, a modest increase from the prior year-over-year number of 3.6%.

Labor Market

U.S. nonfarm payrolls rose by 136,000 in September, slightly below expectations of 145,000. However, August payrolls were revised higher by 38,000. On a trailing 3-month and 6-month average basis, payrolls increased an average of about 157,000 and 154,000 per month, respectively. The unemployment rate declined to 3.5% (the lowest rate since December 1969) from 3.7% in August, and the participation rate held steady at 63.2%. 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, dropped to 6.9% in September from 7.2% in August. Wages were flat in September, missing expectations for a 0.3% increase, and the average workweek was unchanged. On a year-over-year basis, wages were up 2.9% in September, versus up 3.2% in August.

Housing Starts

Housing starts were much stronger than expected in August, up 12.3% month-over-month to a 1.364 million annualized rate. Multi-family starts jumped 32.8% month-over-month to an annualized rate of 445,000, while single-family starts rose 4.4% to an annualized rate of 919,000. On a year-over-year basis, total housing starts were up 6.6% in August. Permits were also stronger than expected in the month. Although housing data tends to be volatile on a month-over-month basis, the August report and three-month moving averages suggest that housing activity is accelerating.

Credit Spreads Narrowed Slightly in September

CREDIT SPREADS	Spread to Treasuries (%)	One Month Ago (%)	Change
3-month top rated commercial paper	0.15	0.10	0.05
2-year A corporate note	0.38	0.47	(0.09)
5-year A corporate note	0.64	0.69	(0.05)
5-year Agency note	0.08	0.08	0

Source: Bloomberg Data as of 9/30/2019

Economic Data Remains Consistent with Slow Growth

ECONOMIC INDICATOR	Current Release	Prior Release	One Year Ago
Trade Balance	(54.9) $Bln AUG 19	(54.0) $Bln JUL 19	(54.9) $Bln AUG 18
GDP	2.0% JUN 19	3.1% MAR 19	3.5% JUN 18
Unemployment Rate	3.5% SEP 19	3.7% AUG 19	3.7% SEP 18
Prime Rate	5.0% SEP 19	5.25% AUG 19	5.25% SEP 18
CRB Index	173.9399 SEP 19	170.3556 AUG 19	195.1592 SEP 18
Oil (West Texas Int.)	$54.07 SEP 19	$55.1 AUG 19	$73.25 SEP 18
Consumer Price Index (y/o/y)	1.7% AUG 19	1.8% JUL 19	2.7% AUG 18
Producer Price Index (y/o/y)	0.2% AUG 19	0.8% JUL 19	3.7% AUG 18
Dollar/Euro	1.09 SEP 19	1.10 AUG 19	1.160 SEP 18

Source: Bloomberg