



# Monthly Market Review

It could be that the Trump tariff strategy is really designed to pressure the Federal Reserve (Fed) to lower interest rates. If so, rates below 1% are not out of the question.

## Economic Highlights

- The trade war rolls on. Amidst on-again, off-again U.S.-China tariff spats and the resultant spikes in market volatility, investors have to digest a new Fed monetary policy outlook and reduced global growth prospects. While the domestic economy savors the tenth year of this epic expansion, it's the headwinds abroad that remain the most imminent detractors.
- The advance release of second quarter U.S. gross domestic product (GDP) indicated the U.S. economy grew at 2.1%, trailing the 3.1% growth from the prior quarter, but outpacing consensus expectations of 1.8%. Growth was propelled by a jump in personal consumption to 4.3%, an increase from the prior quarter of 1.1% and the largest quarterly consumption figure since December 2017. On the downside, fixed investment posted its first negative contribution to GDP since the fourth quarter of 2015, a development worth monitoring as sustained periods of negative fixed investment typically precede economic downturns.
- At the long-awaited July 2019 Fed meeting, the committee (as widely anticipated) cut the overnight fed funds target rate by 25 basis points (bps) to a new range of 2.00% to 2.25%. This marked the first Fed rate cut since December 2008. Fed Chair Jerome Powell had set the stage for preemptive monetary policy to stoke growth and noted the cut was "in light of the implications of global developments for the economic outlook as well as muted inflation pressures." Despite the cut, the balance of the Fed's post-meeting commentary leaned hawkish, led by the dissenting votes of two Fed members (preferring no change).
- Inflation remains muted. The Consumer Price Index (CPI) indicates inflation near 2%, but the Fed's preferred gauge, the Personal Consumption Expenditure (PCE) Index, grew at 1.6% over the year through June, notably below the 2% target. Inflation remains the focus of future Fed policy. Stay tuned.
- The U.S. labor market is a tailwind to the economy. The July jobs report indicated the economy generated 164,000 jobs, in line with expectations of 165,000. The unemployment rate remained unchanged at 3.7%, near the 50-year low, and the labor force participation rate ticked higher to 63.0%.

## Bond Markets

- After months of yield declines across all maturities, yields on intermediate maturities (one-10 years) rose modestly while yields of long and very short maturities declined.
- As a result, intermediate-term Treasury indices generated negative total returns for the month, while very short- and longer-term indices were positive. For example, the 3-month and 30-year constant maturity U.S. Treasury Index returned 0.18% and 0.21%, respectively. Meanwhile, the 2-year, 5-year, and 10-year indices generated total returns of -0.14%, -0.26%, and -0.01%, respectively, for the month.

- The trend of lower yields resumed in early August with Treasury rates rallying significantly and more than offsetting the increases in July.
- Spread sectors (including investment-grade credit, AAA-rated asset-backed securities, and mortgage-related sectors) generated positive excess returns (that is, returns higher than those of comparable Treasuries) for the month, benefiting well-diversified portfolios.

## Equity Markets

- U.S. equities rose in July. The S&P 500 Index increased 1.4%, the Dow Jones Industrial Average was up 1.1% and the NASDAQ climbed 2.2%. The first few days of August shifted the narrative just as it did for bonds with equities giving up their July gains.
- The U.S. Dollar Index (DXY), measured against a basket of international currencies, increased in July by 2.5%, and closed the month at a two-year high.

## PFM Outlook

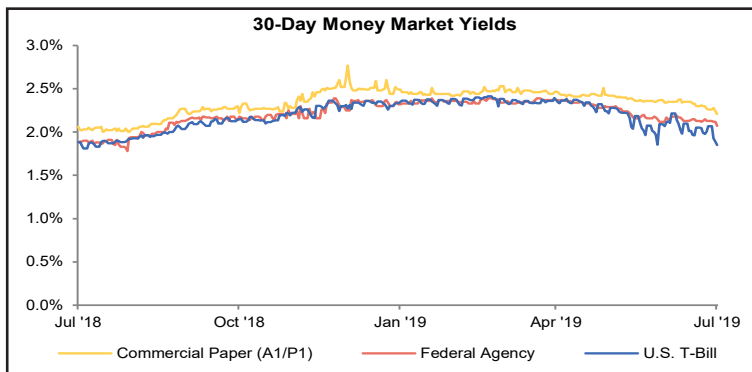
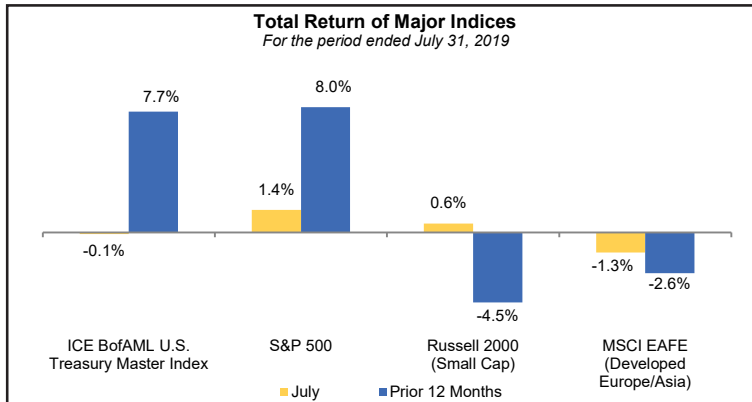
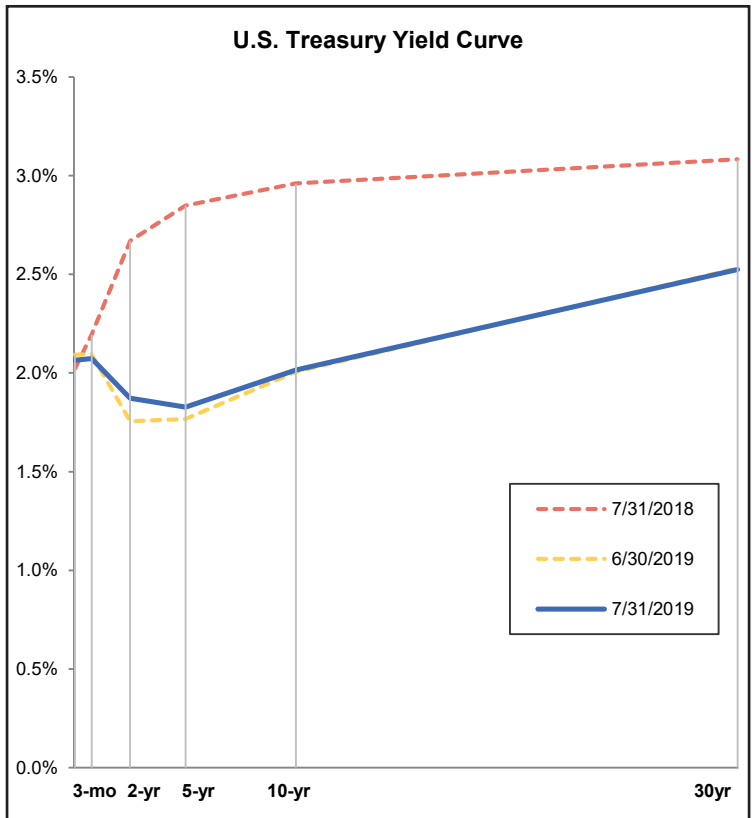
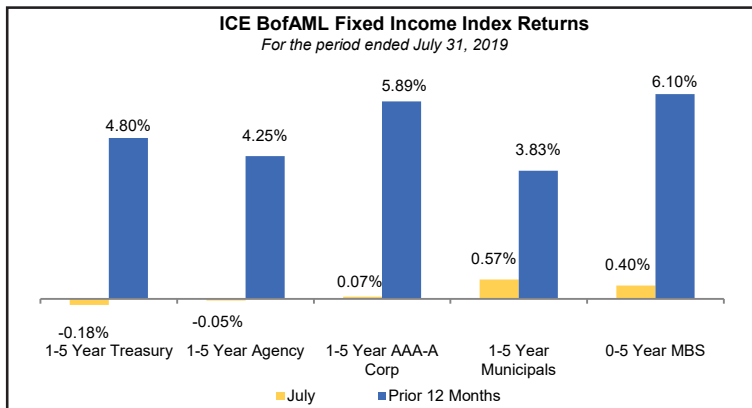
- With the Fed in easing mode and the trade war brewing we will continue to maintain portfolio durations with a neutral stance relative to benchmarks. While this may mean giving up near-term income because of the inverted yield curve, a neutral duration strategy helps reduce the risk of underperforming benchmarks in the event yields continue to fall.
- Federal agency yields remain tightly spread to comparable Treasuries. Thus we continue to favor Treasuries over most agency bonds, sometimes selling agency bonds at levels more expensive than Treasury securities of similar maturity.
- Investment-grade (IG) credit generated positive excess returns for the third consecutive month in July. As a result, the sector is the year-to-date top performer by a wide margin. We will maintain current exposure in the sector; however, we advise caution as spreads approach 12-month tightness on the heels of strong performance results.
- Mortgage-backed securities (MBS) rebounded in July following a surge in prepayment expectations in the second quarter. The outlook for MBS performance remains very much tied to long term interest rates and the resultant impact on prepayment estimates. As a result, MBS strategy focuses on those securities that exhibit less sensitivity to interest rate risks under adverse conditions.
- The inverted yield curve provides short-term investors with attractive current yields, but short-term investments are the most sensitive to future Fed rate moves. In the 12-month and under maturity range high quality credit instruments such as commercial paper offer modest opportunities for incremental income.

U.S. Treasury Yields				
Duration	July 31, 2018	June 30, 2019	July 31, 2019	Monthly Change
3-Month	2.02%	2.09%	2.07%	-0.02%
6-Month	2.19%	2.10%	2.07%	-0.03%
2-Year	2.67%	1.76%	1.87%	0.11%
5-Year	2.85%	1.77%	1.83%	0.06%
10-Year	2.96%	2.01%	2.02%	0.01%
30-Year	3.08%	2.53%	2.53%	0.00%

Yields by Sector and Maturity as of July 31, 2019				
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	2.07%	2.03%	2.21%	--
6-Month	2.07%	1.98%	2.22%	--
2-Year	1.87%	1.93%	2.26%	1.20%
5-Year	1.83%	1.93%	2.38%	1.34%
10-Year	2.02%	2.25%	2.81%	1.73%
30-Year	2.53%	2.72%	3.61%	2.40%

Spot Prices and Benchmark Rates				
Index	July 31, 2018	June 30, 2019	July 31, 2019	Monthly Change
1- Month LIBOR	2.08%	2.40%	2.22%	-0.18%
3- Month LIBOR	2.35%	2.32%	2.27%	-0.05%
Effective Fed Funds Rate	1.91%	2.40%	2.40%	0.00%
Fed Funds Target Rate	2.00%	2.50%	2.25%	-0.25%
Gold (\$/oz)	\$1,224	\$1,414	\$1,426	\$12
Crude Oil (\$/Barrel)	\$68.76	\$58.47	\$58.58	\$0.11
U.S. Dollars per Euro	\$1.17	\$1.14	\$1.11	-\$0.03

Economic Indicators				
Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales MoM	16-Jul	Jun	0.4%	0.2%
New Home Sales MoM	24-Jul	Jun	7.0%	5.1%
GDP Annualized QoQ	26-Jul	2Q A	2.1%	1.8%
Consumer Confidence	30-Jul	Jul	135.7	125.0
FOMC Rate Dec. (Upper)	31-Jul	Jul	2.25%	2.25%
ISM Manufacturing	1-Aug	Jul	51.2	52.0
Non-farm Payrolls	2-Aug	Jul	164k	165k



Source: Bloomberg. Data as of July 31, 2019, unless otherwise noted. The views expressed constitute the perspective of PFM Asset Management LLC at the time of distribution and are subject to change. The content is based on sources generally believed to be reliable and available to the public; however, PFM cannot guarantee its accuracy, completeness or suitability. This material is for general information purposes only and is not intended to provide specific advice or a specific recommendation. PFM is the marketing name for a group of affiliated companies providing a range of services. All services are provided through separate agreements with each company. Investment advisory services are provided by PFM Asset Management LLC which is registered with the SEC under the Investment Advisers Act of 1940. For more information regarding PFM's services or entities, please visit [www.pfm.com](http://www.pfm.com).

