Monthly Market Review

So we beat on, boats against the current...

Economic Highlights

- As investors set sail into the new decade, we reflect on the remarkable decade now behind us. The 2010s overcame upheavals in the geopolitical order, credit and oil shocks, and sovereign meltdowns. And despite these volatile winds, equities had an epic bull market run; bonds also had a bull market run; and the U.S. Dollar reigned supreme, enjoying its unique privilege amid unprecedented monetary expansion by major central banks.
- After three consecutive rate cuts, the Federal Reserve (Fed) kept rates steady at its December meeting, maintaining the target range at 1.5% to 1.75%. It signaled a view that the economy is solid and the current policy stance will remain appropriate as long as "incoming data remains broadly consistent with the outlook."
- The final estimate of third quarter U.S. gross domestic product (GDP) growth was unrevised at 2.1%. The consumer provided much-needed ballast to the economy.
- The U.S. economy added 145,000 jobs in December. The positive yet weaker-than-expected payroll report suggested momentum has eased. The unemployment and labor force participation rates were both unchanged at 3.5% and 63.2%, respectively.
- Although the "Phase One" trade deal with China was not yet signed in December, the markets gave a positive signal in that equities continued to move higher and yield spreads remain low and well-contained.
- December releases revealed that inflation pressures were muted. While price pressures on services were stable, pressures on goods drifted lower amid a gradual de-escalation in tariff measures. Core personal consumption expenditure (PCE) remains below the Fed's 2% target.
- Housing fundamentals were steady. Existing home sales fell in November, while new home sales increased, making this the best three months since 2007.

Bond Markets

- The U.S. Treasury yield curve steepened during December. Ultra-short (less than three months) Treasury yields fell 15 basis points (bps) as the front end of the curve sought equilibrium with the Fed target rate. Yields on maturities between three months and five years were generally flat (+/- five bps), while yields on longer Treasuries (greater than seven years) increased 10 to 20 bps.
- As result of the uneven yield curve move, short- and intermediate-term Treasuries outperformed longer maturities. For example, the 3-month and 2-year Constant Maturity U.S. Treasury Indexes returned 0.14% and 0.23%, respectively. Meanwhile, the 10-year and 30-year indexes generated total returns of -1.02% and -3.51%, respectively.
- Buoyed by stable credit fundamentals, accommodative central banks and modest new supply, credit sectors once again generated strong incremental performance. By month-end, high-quality credit spreads had reached historically tight levels, making valuations appear rich.

Equity and Currency Markets

- U.S equities finished the year with a strong December, marking the best year since 2013. Over the month, the S&P 500 advanced 3.0% which pushed 2019's return to 31.5%. The NASDAQ added 3.6% for the month and posted an impressive 36.7% annual gain, its best year since 2009, while the Dow added 1.9% to return 25.3% for the year.
- Non-U.S. equities, as represented by the MSCI ACWI ex-U.S. Index, returned 4.33% and emerging market equities, represented by the MSCI Emerging Markets Index, rose 7.46%. Global trade uncertainty diminished and economic data recovered.

PFM Outlook

- Following the Fed's three 2019 "rate adjustment" cuts, and with the economy expanding modestly, we expect interest rates to remain range bound over the near-term. As a result, we plan to maintain duration positions neutral to benchmarks.
- Federal agency and supranational yield spreads traded in a very tight range for much of 2019, and remain near multi-year tights. While we generally expect a similar environment in 2020, if supply flow were to come about at reasonable spread levels we may add to our current reduced allocations. In the meantime, we continue to use Treasury allocations as a safe harbor and core holding.
- The investment-grade (IG) credit sector was a boon for fixed income investors in December and for most of 2019. Spreads now are at the point of testing post-recession lows. We continue to be "opportunistic sellers," to reduce allocations modestly, and increase the average credit quality of holdings.
- Mortgage-backed securities (MBS) posted strong excess returns for the third consecutive month. As a result, spreads in the sector have tightened noticeably from August's wide levels and closed the year around their trailing 12-month average. We will continue to build additional core allocations to MBS, with an eye on security structure, loan characteristics and interest rate sensitivity.
- Shorter-term investors (less than one year) may continue to benefit from widened yield spreads on commercial paper and negotiable certificates of deposit and return to a more normal, upward sloping yield curve.
- After the strong bond market returns of 2019, we expect results in virtually all sectors to be lower this year.

U.S. Treasury Yields

Duration	Dec 31, 2018	Nov 30, 2019	Dec 31, 2019	Monthly Change
3-Month	2.36%	1.58%	1.55%	-0.03%
6-Month	2.48%	1.61%	1.59%	-0.02%
2-Year	2.49%	1.61%	1.57%	-0.04%
5-Year	2.51%	1.63%	1.69%	0.06%
10-Year	2.69%	1.78%	1.92%	0.14%
30-Year	3.02%	2.21%	2.39%	0.18%

Yields by Sector and Maturity as of November 30, 2019

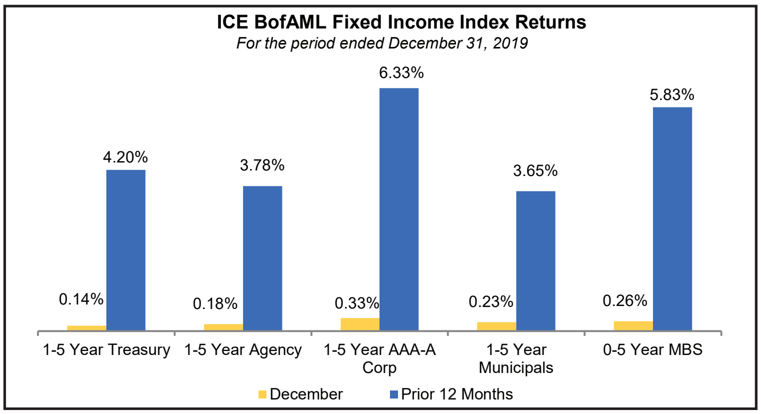
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	1.55%	1.53%	1.85%	--
6-Month	1.59%	1.48%	1.85%	--
2-Year	1.57%	1.58%	1.86%	1.18%
5-Year	1.69%	1.74%	2.09%	1.23%
10-Year	1.92%	2.15%	2.60%	1.57%
30-Year	2.39%	2.71%	3.40%	2.19%

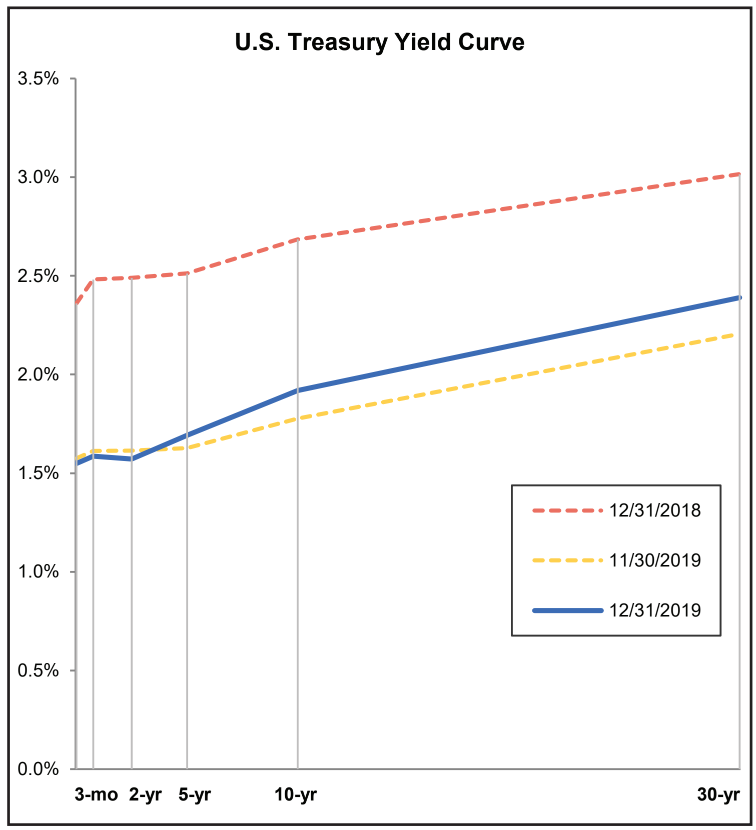
Spot Prices and Benchmark Rates

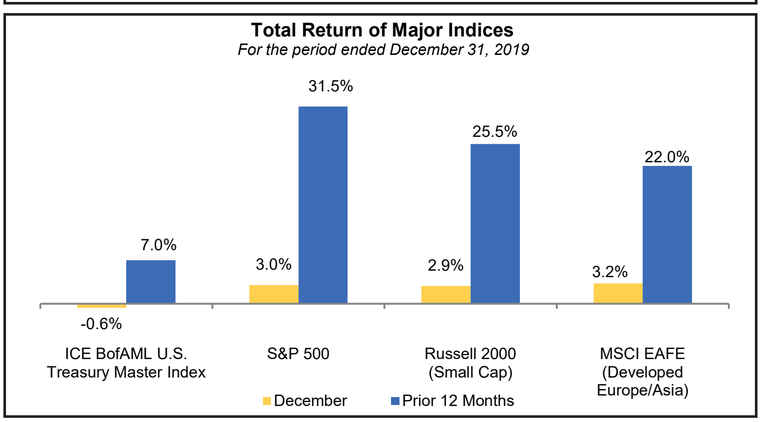
Index	Dec 31, 2018	Nov 30, 2019	Dec 31, 2019	Monthly Change
1-Month LIBOR	2.50%	1.70%	1.76%	0.06%
3-Month LIBOR	2.81%	1.91%	1.91%	0.00%
Effective Fed Funds Rate	2.40%	1.56%	1.55%	-0.01%
Fed Funds Target Rate	2.50%	1.75%	1.75%	0.00%
Gold ($/oz)	$1,281	$1,466	$1,523	$58
Crude Oil ($/Barrel)	$45.41	$55.17	$61.06	$5.89
U.S. Dollars per Euro	$1.15	$1.10	$1.12	$0.02

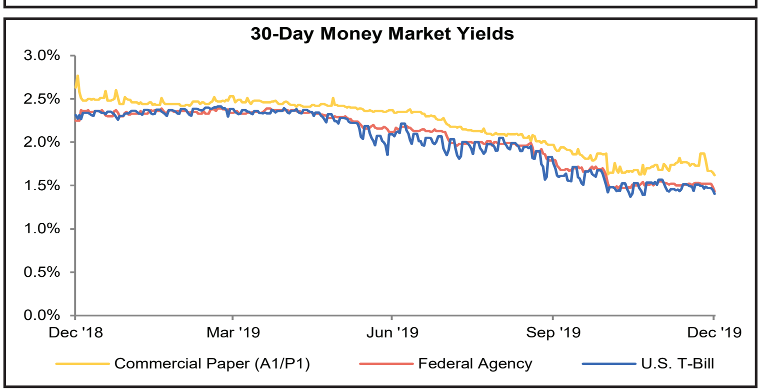
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Consumer Confidence	31-Dec	Dec	126.5	128.5
GDP Annualized QoQ	20-Dec	3Q T	2.10%	2.10%
PCE Core Deflator YoY	20-Dec	Nov	1.6%	1.5%
FOMC Rate Decision (Upper)	11-Dec	Dec	1.75%	1.75%
Non-farm Payrolls	10-Jan	Dec	145k	160k
Unemployment Rate	10-Jan	Dec	3.5%	3.5%
ISM Manufacturing	3-Jan	Dec	47.2	49.0









Source: Bloomberg. Data as of December 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.