Monthly Market Review

"Want to ride a roller coaster?" Try the bond market, where the 10-year Treasury yield fluctuated nearly 40 basis points (bps) in May.

Economic Highlights

- The month began by riding on the coattails of April, with strong readings on the labor market, consumer and business confidence, and record corporate profits. Geopolitical concerns (e.g., North Korea, tariffs and Russia) were seemingly pushed to the sidelines as interest rates rose to new cycle highs and equity prices rebounded from the volatile market conditions of earlier this year.
- Italy's woes triggered a sizable late-month sell-off in stocks around the globe, while also causing a flight-to-quality in the bond markets that briefly pushed yields lower by 30 to 40 bps during a few days. The markets began to recover in early June despite Italy's installation of a new populist prime minister.
- The unemployment rate fell to 3.8% in May, matching its lowest level since December 1969. Similarly, the U.S. reached multi-decade lows in initial and continuing jobless claims.
- The May labor market report indicated a net increase of 223,000 jobs, outpacing expectations by 33,000. During the past year, the economy has added about 200,000 jobs per month, on average. At the same time, average hourly earnings—an important measure of wage growth—has risen a respectable, but not spectacular, 2.7% year-over-year (YOY).
- The second estimate for first-quarter Gross Domestic Product (GDP) was revised slightly lower to 2.2%. Growth averaged 2.8% during the past year, the best reading in two-and-a-half-years.
- Meanwhile, inflation, as measured by the YOY Personal Consumption Expenditure (PCE) Index, held at 1.8% and is closing in on the Federal Reserve's (Fed) 2% inflation target.
- As expected, the Federal Open Market Committee (FOMC) left short-term rates unchanged at its meeting in May, keeping the current range of 1.50% to 1.75%. The Fed is widely expected to hike rates as the year progresses, though the question of how many hikes—most observers see two or three—remains unknown.

Bond Markets

- The U.S. Treasury yield curve flattened noticeably throughout May, as short-term yields rose while yields on longer maturities fell. For example, the yield of the three-month Treasury bill (T-bill) rose 10 bps to end the month at 1.90%, while the 10-year note fell nine bps to 2.86%. After breaching the psychological barrier of 3% during the month, the 10-year Treasury retreated by 37 bps from an intra-month high of 3.12% to an intra-month low of 2.75%, ending the month at 2.86%.
- As a result of the flight-to-quality trade near month-end, longer-maturity fixed-income indices outperformed their short-term counterparts in May. For example, the 10-year constant maturity Treasury index returned 1.11% for the month, while the three-month T-bill returned just 0.15%.
- Despite marginally wider credit spreads, investment-grade corporate bonds performed generally in line with Treasury indices with comparable durations, as incremental income earned on corporates mitigated the adverse price impact of wider spreads.

Equity Markets

- The resilience of domestic equity markets was demonstrated in May, as the S&P 500 Index (S&P) shrugged off two separate sell-offs of nearly 1% during the month and still managed to garner a 2.4% positive total return. Following the S&P's strong month, the headline domestic equity index is now up 2.02% year-to-date (YTD).
- Sector performance within the S&P was mixed, but generally positive with seven of the 11 sectors posting positive returns. Information Technology, Energy and Industrials led gains, returning 7.37%, 3.04% and 3.01%, respectively. Telecom, Consumer Staples and Utilities led declines, returning -2.28%, -1.53% and -1.13%, respectively.
- The U.S. Dollar (USD) Index continued its ascent last month, marking the second consecutive monthly increase. The 2.3% increase in May, which followed an April increase of 2.1%, pushed the USD to its highest level in six months.

PFM Outlook

- The combination of at least two more expected Fed rate hikes in 2018, with the potential for additional hikes following in 2019, supports our view that interest rates will trend higher over the near-term. As a result, we believe a defensive portfolio structure – with durations modestly shorter than indices – is warranted to both mitigate interest rate risks and position portfolios for increased future earnings from higher reinvestment rates.
- The Federal Agency spread curve, which is the incremental yield relative to similar maturity U.S. Treasury securities, remains extremely narrow, as the majority of maturities of less than five years offer less than five bps of incremental return. As a result, we continue to reduce holdings of these "rich" issues.
- With Agency spreads narrow, we have strongly favored purchases of supranationals during the past several months. However, new issuance ground to a halt in May, causing spreads to collapse. While increased allocations have added value YTD, we expect any future purchases of supranationals to be limited and more strategic.
- Our view of the corporate sector remains constructive as healthy fundamentals continue to outweigh potential headwinds. Our outlook on value and risk, however, has become more industry- and company-specific as broad categories, such as credit rating groups, can mask important details. AAA-rated Asset-Backed Securities (ABS) are a defensive alternative to gain credit exposure.
- Short-term money market investors continue to reap the rewards of current monetary policy tightening and higher overnight target rates. Yields on high-quality commercial paper (CP) and negotiable certificates of deposit (CDs) are attractive, especially in three- to six-month maturities.

U.S. Treasury Yields

Maturity	May 31, 2017	Apr 30, 2018	May 31, 2018	Monthly Change
3-Month	0.97%	1.80%	1.90%	0.10%
6-Month	1.07%	2.01%	2.08%	0.07%
2-Year	1.28%	2.49%	2.43%	-0.06%
5-Year	1.75%	2.80%	2.70%	-0.10%
10-Year	2.20%	2.95%	2.86%	-0.09%
30-Year	2.86%	3.12%	3.03%	-0.09%

Yields by Sector and Maturity as of May 31, 2018

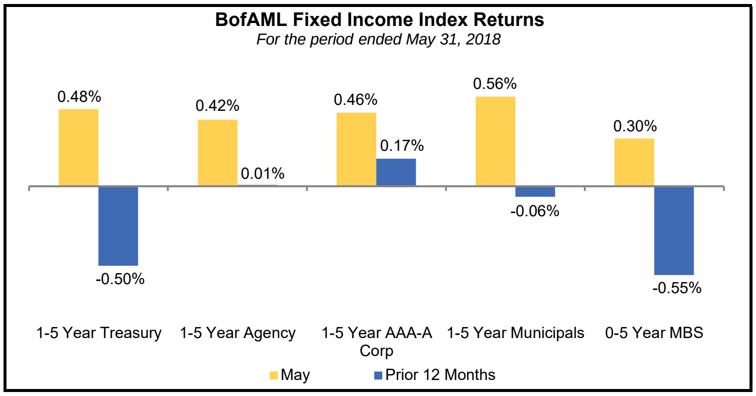
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	1.90%	1.90%	1.80%	-
6-Month	2.08%	1.98%	2.45%	-
2-Year	2.43%	2.50%	2.87%	1.72%
5-Year	2.70%	2.78%	3.29%	2.00%
10-Year	2.86%	3.12%	3.78%	2.40%
30-Year	3.03%	3.25%	4.21%	2.94%

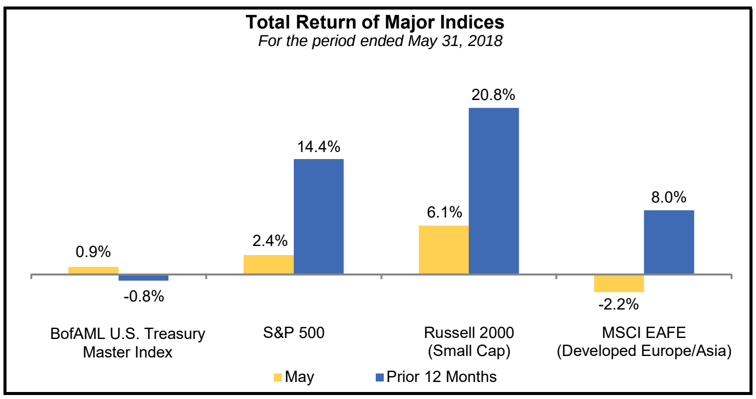
Spot Prices and Benchmark Rates

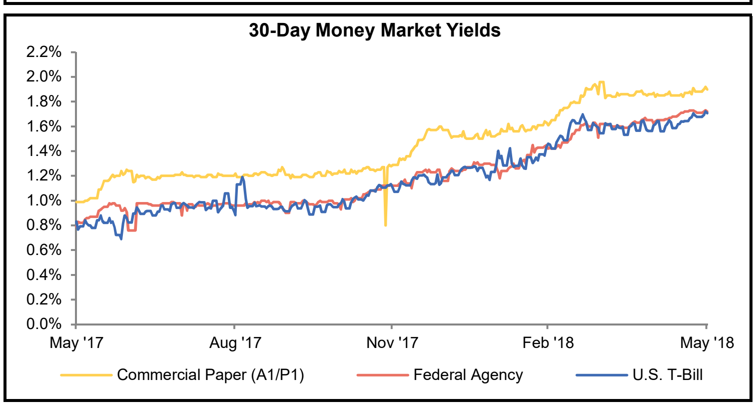
Index	May 31, 2017	Apr 30, 2018	May 31, 2018	Monthly Change
1-Month LIBOR	1.06%	1.91%	2.00%	0.09%
3-Month LIBOR	1.21%	2.36%	2.32%	-0.04%
Effective Fed Funds Rate	0.83%	1.69%	1.70%	0.01%
Fed Funds Target Rate	1.00%	1.75%	1.75%	0.00%
Gold ($/oz)	$1,272	$1,319	$1,300	-$19
Crude Oil ($/Barrel)	$48.32	$68.57	$67.04	-$1.53
U.S. Dollars per Euro	$1.12	$1.21	$1.17	-$0.04

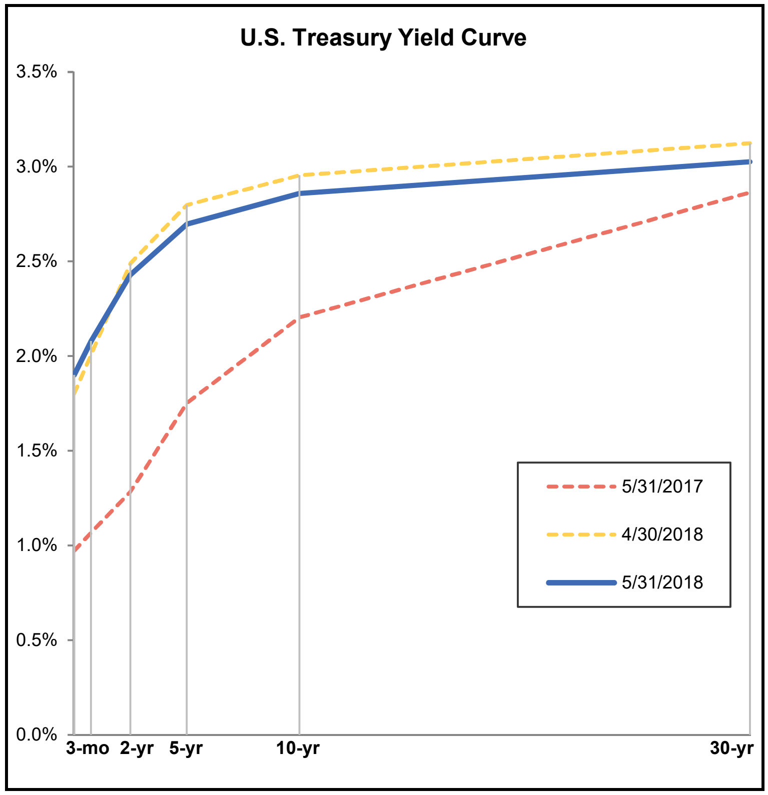
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Nonfarm Payrolls	1-Jun	May	223k	190k
CPI ExFood&Energy YoY	10-May	Apr	2.1%	2.2%
Retail Sales MoM	15-May	Apr	0.3%	0.3%
Consumer Confidence	29-May	May	128.0	128.0
GDP Annualized QoQ	30-May	1Q	2.2%	2.3%
New Home Sales MoM	23-May	Apr	-1.5%	-2.1%
FOMC Rate Dec. (Upper)	2-May	May	1.75%	1.75%









Source: Bloomberg. Data as of May 31, 2018 unless otherwise noted.

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