Monthly Market Review

The march to higher interest rates took on a new tone in October as investors shunned longer maturities and riskier investments, beating down the prices of long-term Treasuries and corporate and mortgage-backed securities (MBS), even as signs emerged that the pace of global growth would soon slow.

Economic Highlights

- The U.S. stock market gave up nearly all its gains for the year as investors became concerned about rising rates, the upcoming midterm elections, future corporate earnings, a trade war with China, Brexit, Italian budget woes and general geopolitical uncertainty.
- The advance release of third-quarter U.S. gross domestic product (GDP) showed surprisingly strong growth of 3.5%, boosted by consumer spending, government spending and inventory replenishment. These factors more than offset weak business investment and the biggest drag from trade in 33 years.
- The U.S. economy added 250,000 new jobs in October, well above estimates, while the unemployment rate remained unchanged at 3.7% – the lowest since 1969.
- Average hourly earnings – an important measure of wage growth – rose 3.1% year over year (YoY), the fastest pace since 2009.
- The Federal Reserve's Beige Book–released in advance of the November Federal Open Market Committee (FOMC) meeting–was subdued, noting "modest to moderate growth" in economic activity from a majority of Federal Reserve (Fed) Districts. In particular, manufacturers reported moderate output growth, citing concerns over rising materials and shipping costs, trade uncertainty and difficulty finding qualified workers.
- The U.S. housing market has weakened as rising home prices, higher mortgage rates, a scarcity of materials and lack of construction labor have slowed activity. Residential investment fell 4% in the third quarter, the third consecutive quarter as a drag to GDP growth. A drop in forward indicators, like housing starts and building permits, portends further weakness in the months ahead.
- The U.S. dollar (USD) pushed higher over the month, increasing the drag on exports and corporate earnings, especially those of multinational companies. It also does not bode well for emerging-market (EM) economies because a significant portion of their debt is denominated in USD, which became more costly to pay back.

Bond Markets

- U.S. Treasury yields rose in early October to new highs for this phase of the cycle, with 10-year and two-year yields reaching their highest levels since 2011 and 2008, respectively. But, the sell-off in equity markets triggered a brief rally that left yields higher for the month, though off their highs. The 30-year Treasury led rate increases, rising by 20 basis points (bps) (0.20%) during the month.
- The five- to 30-year part of the Treasury yield curve steepened during October, partially reversing the strong flattening trend of the past several years.
- Fixed-income returns were mixed for the month. For example, one- and five-year Treasuries returned 0.20% and 0.10%, respectively. Meanwhile, 10- and 30-year maturities returned -0.60% and -3.64%, respectively.

Equity Markets

- After posting all-time highs in September, U.S. equities neared "correction territory" in October. The Nasdaq Composite Index plunged 9.2%, the S&P 500 Index (S&P) fell 6.8% and the Dow Industrials tumbled 5.0%, leaving only modest gains for the year. Sector performance within the S&P was mostly negative in October with nine of the 11 sectors posting negative returns.
- By market capitalization, large-caps (Russell 1000 Index) were the best performers during the month. Value stocks outperformed growth stocks within all three market capitalizations.

PFM Outlook

- A myriad of recent speeches and post-FOMC meeting statements seemed to affirm the Fed's commitment to continue the current tightening cycle. This affirmation, in combination with a solid domestic economic backdrop and the possibility of additional rate hikes in coming quarters, leads us to continue positioning portfolios with a defensive interest rate risk profile – durations will remain short of benchmarks.
- Federal agency yield spreads relative to U.S. Treasuries remain very tight. Light issuance from government-sponsored enterprises (GSEs) through the balance of the year should be modestly supportive of performance in the sector over the near-term.
- Supranational issuers are nearing the end of their fiscal year, and new issuance is expected to be quiet over the next couple of months. We will minimize new purchases in an effort to gear up for seasonal supply upticks early next year.
- Corporate debt faced a tough October as credit spreads widened with the equity market sell-off and volatility spiked. Headwinds facing the sector, such as higher rates and perhaps peak earnings, have begun to impact our views on future return prospects. As a result, we will continue to be more selective when evaluating corporate debt offering. We will also continue to reduce holdings of issues where yield spreads have tightened to expensive levels.
- MBS returns continue to lag. And, with Fed balance sheet holdings in MBS set for more significant reduction over the next quarter, new purchases will be limited and selective.
- AAA-rated asset-backed securities (ABS) continue to generate positive excess returns. The sector offers a defensive bias to credit allocations, and we will continue to overweight ABS.
- With the effective federal funds rate at over 2%, money market funds and ultra-short-term fixed-income investments have been among the best performers year-to-date (YTD). A seasonal rise in issuance of Treasury bills may present an attractive risk-free alternative as we move into the new year.

U.S. Treasury Yields

Maturity	Oct 31, 2017	Sep 30, 2018	Oct 31, 2018	Monthly Change
3-Month	1.13%	2.20%	2.33%	0.13%
6-Month	1.28%	2.37%	2.49%	0.12%
2-Year	1.60%	2.82%	2.87%	0.05%
5-Year	2.02%	2.95%	2.98%	0.03%
10-Year	2.38%	3.06%	3.14%	0.08%
30-Year	2.88%	3.21%	3.39%	0.18%

Yields by Sector and Maturity as of October 31, 2018

Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	2.33%	2.27%	2.72%	-
6-Month	2.49%	2.43%	2.80%	-
2-Year	2.87%	2.93%	3.26%	1.98%
5-Year	2.98%	3.10%	3.57%	2.29%
10-Year	3.14%	3.40%	4.00%	2.74%
30-Year	3.39%	3.68%	4.53%	3.34%

Spot Prices and Benchmark Rates

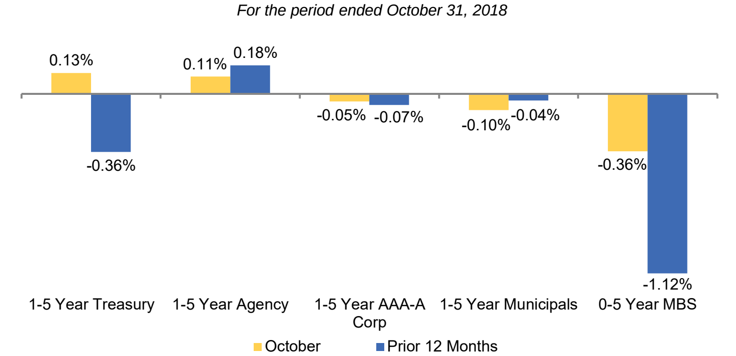
Index	Oct 31, 2017	Sep 30, 2018	Oct 31, 2018	Monthly Change
1-Month LIBOR	1.24%	2.26%	2.31%	0.05%
3-Month LIBOR	1.38%	2.40%	2.56%	0.16%
Effective Fed Funds Rate	1.07%	2.18%	2.20%	0.02%
Fed Funds Target Rate	1.25%	2.25%	2.25%	0.00%
Gold ($/oz)	$1,271	$1,192	$1,215	$24
Crude Oil ($/Barrel)	$54.38	$73.25	$65.31	-$7.94
U.S. Dollars per Euro	$1.16	$1.16	$1.13	-$0.03

Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Nonfarm Payrolls	2-Nov	Oct	250k	200k
CPI ExFood&Energy YoY	11-Oct	Sep	2.2%	2.3%
Retail Sales MoM	15-Oct	Sep	0.1%	0.4%
Consumer Confidence	30-Oct	Oct	137.9	135.9
GDP Annualized QoQ	26-Oct	3Q Adv	3.5%	3.3%
New Home Sales MoM	24-Oct	Sep	-5.5%	-0.6%
FOMC Rate Dec. (Upper)	8-Nov	Nov	2.25%	2.25%

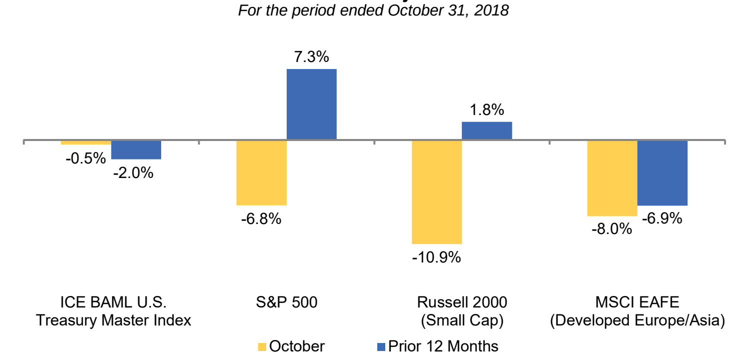
ICE BAML Fixed Income Index Returns

For the period ended October 31, 2018

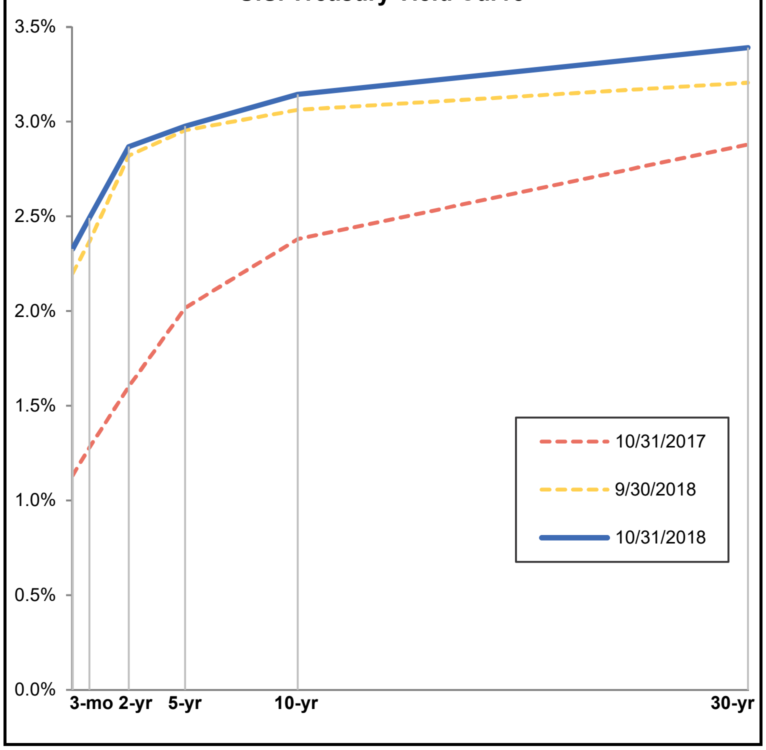


Total Return of Major Indices

For the period ended October 31, 2018



U.S. Treasury Yield Curve



30-Day Money Market Yields