



Monthly Market Review

The end of summer seems to have jolted fixed-income investors awake to the fact that the Federal Reserve (Fed) is firmly on a path to raise short-term rates. The result: rates across the interest rate curve have risen, stocks have fallen and market volatility has turned sharply upward. Oh, for the days of summer.

Economic Highlights

- U.S. equities had a great quarter, registering the best returns in nearly five years, as the S&P 500 (S&P) rose more than 7% and hit new all-time highs in September, before plummeting after quarter-end. Stocks benefitted from tailwinds of robust economic fundamentals, strong corporate earnings and business optimism. But the outlook clouded in October, threatening valuations and raising uncertainty.
- The Federal Open Market Committee (FOMC) increased the overnight lending rate by 0.25% to a new target range of 2% to 2.25% at its September meeting, marking the third hike this year. Perhaps more significantly, the Fed ended the use of the word “accommodative.” This suggests additional hikes in coming months, but also adds uncertainty to rate forecasts.
- The U.S. economy added 134,000 new jobs in September, but this seemingly weak number was offset by sharp upward revisions in prior month estimates. Overall, the pace has averaged a healthy 200,000 jobs per month, enough to push the unemployment rate to 3.7%—a 48-year low.
- On the inflation front, many gauges of price increases are now at or near the Fed’s 2% target. Wage growth has ticked up, oil prices have spiked on supply constraints and tariffs threaten to push up the cost of imported goods—all factors that could portend higher inflation in the future.
- The final update to second-quarter gross domestic product (GDP) indicated the U.S. economy grew at an annual rate of 4.2%—the fastest pace since the third quarter of 2013. At the same time, growth in Europe and some key emerging market economies, such as China, are slowing, posing a risk to the “synchronized global growth” story of the past few years.
- The U.S., Canada and Mexico reached agreement on updates to NAFTA. While the deal revises some country-of-origin, intellectual property and environmental rules, the biggest result is the resolution of one significant source of market uncertainty. Meanwhile, however, trade with China showed signs of worsening.

Bond Markets

- The U.S. Treasury yield curve is showing signs of steepening, while short-term rates rose in lockstep with the Fed.
- As a result of higher yields, the majority of investment-grade (IG), fixed-income benchmarks generated negative returns for the month, with shorter-term maturities significantly outperforming their longer-term counterparts. For example, the three-year, five-year and 30-year constant maturity indices returned -0.30%, -0.70% and -3.34%, respectively.

- Among the few positively performing fixed-income sectors for the month were corporates and asset-backed securities (ABS) with maturities of less than three years. These sectors captured incremental income, while credit spreads were stable. Over the last several quarters, income has been a critical component of fixed-income total returns.

Municipal Bond Market

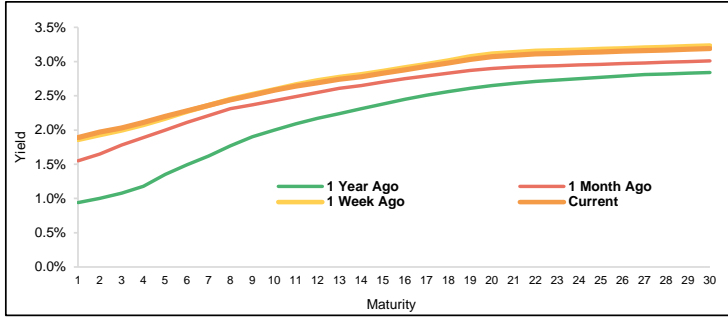
- Municipal new issuance decreased in September by 18.1% to \$24.3 billion from \$29.7 billion the same month last year. Year-to-date (YTD) municipal new issuance is down 14.8% to \$249.8 billion in 2018 from \$293.2 billion during the same period last year, according to Municipal Market Monitor (TM3) data.
- September brought mixed weekly bond flows throughout the month, ultimately ending with net outflows totaling a nominal \$235 million, following August’s net inflows of \$2.33 billion, according to Investment Company Institute (ICI) data.
- The Municipal Market Data (MMD) Index experienced rising rates across the curve in September, with the largest increase on the front end. The one-year rate jumped 29 basis points (bps) to 1.89%, while the three-year rate increased 22 bps to 2.03%. The five-year rate rose 18 bps to 2.20%, while the 10-year rate climbed 16 bps to 2.44%. On the long end, the 30-year rate moved up 19 bps to 3.21%, according to TM3 data.
- The 10-year MMD Single-A General Obligation (GO) Index credit spreads and Double-A GO Index credit spreads remained unchanged at 47 and 17 bps, respectively, according to TM3 data.
- In September, Municipal/Treasury ratios increased on the front end of the yield curve. The two-year ratio climbed to 70% from 64.7% in August, and the five-year ratio increased to 74.8% from 73.7%. The intermediate-term ratio fell to 78.3% from 78.9%, while the 10-year ratio decreased to 84.6% from 85.6%. The 30-year ratio also dropped to 99.9% from 100.7%, according to TM3 data.
- The Municipal curve flattened in September, with the AAA MMD two- through 10-year slope ending at 61 bps, slightly narrower than August’s 74 bps. The slope between the AAA MMD two-through 30-year narrowed to 122 bps from August’s 132 bps.

Spot Rates				
	Current 9/28/2018	1 Week Ago 9/21/2018	1 Month Ago 8/31/2018	1 Year Ago 8/31/2017
2-Year	1.97	1.93	1.65	1.00
3-Year	2.03	2.00	1.78	1.08
5-Year	2.20	2.17	2.00	1.35
7-Year	2.36	2.36	2.21	1.62
10-Year	2.58	2.59	2.43	2.00
30-Year	3.19	3.23	3.01	2.84

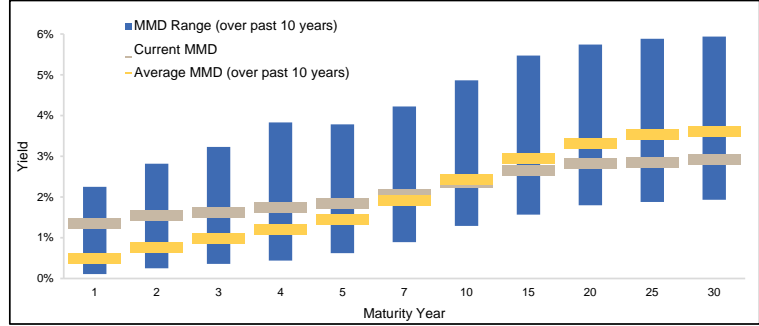
Change in Spot Rate (basis points)			
	1 Week Ago 9/21/2018	1 Month Ago 8/31/2018	1 Year Ago 8/31/2017
2-Year	4	32	97
3-Year	3	25	95
5-Year	3	20	85
7-Year	0	15	74
10-Year	-1	15	58
30-Year	-4	18	35

Market Rates			
Term	MMD AAA GO	U.S. Treasury	Muni Swap Rate
2-Year	1.97%	2.82%	2.02
3-Year	2.03%	2.88%	2.12
5-Year	2.20%	2.95%	2.22
7-Year	2.36%	3.02%	2.30
10-Year	2.58%	3.06%	2.40
30-Year	3.19%	3.21%	2.68

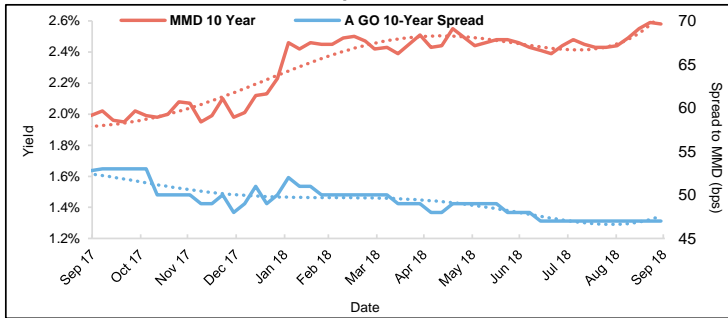
MMD AAA GO Curve



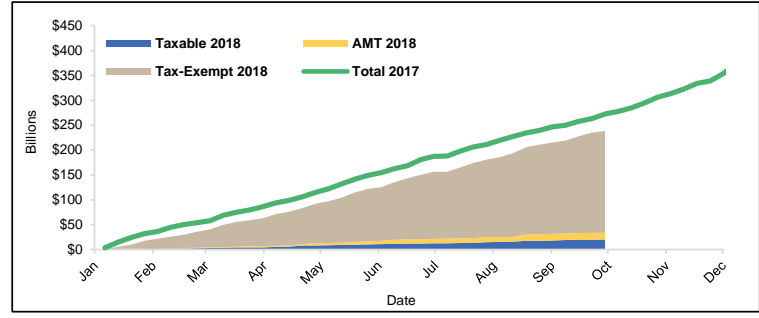
MMD Rates Over Time



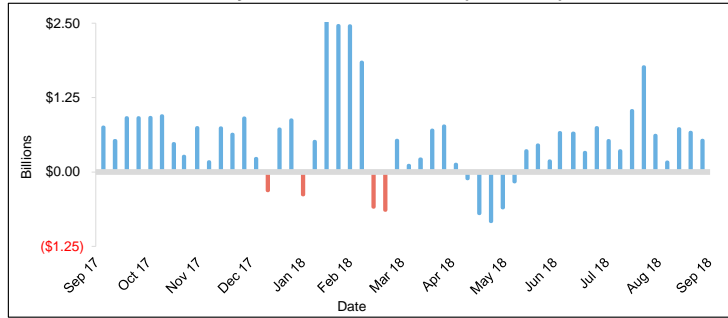
Rate and Spread Movement



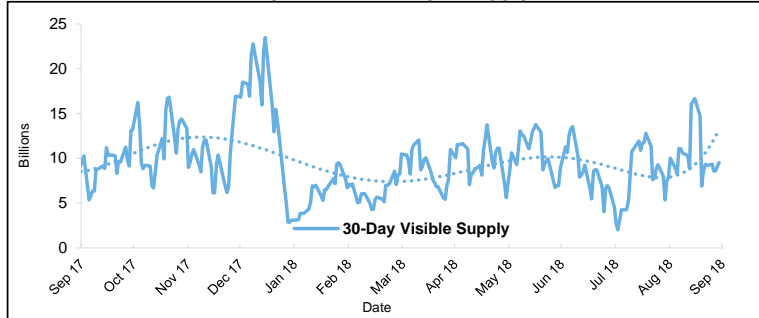
2018 Cumulative Issuance



Weekly Mutual Fund Inflows (Outflows)



30-Day Visible Municipal Supply



Economic Calendar

Date	Time	Statistic	Date	Time	Statistic	Date	Time	Statistic
10/05/2018	08:30 AM	Labor Force Participation Rate	10/17/2018	08:30 AM	Housing Starts	10/24/2018	2:00 PM	U.S. Fed Releases Beige Book
10/09/2018	06:00 AM	NFIB Small Business Optimism	10/17/2018	08:30 AM	Housing Starts MoM	10/25/2018	08:30 AM	Advance Goods Trade Balance
10/10/2018	07:00 AM	MBA Mortgage Applications	10/17/2018	08:30 AM	Building Permits	10/25/2018	08:30 AM	Wholesale Inventories MoM
10/10/2018	08:30 AM	PPI Final Demand MoM	10/17/2018	08:30 AM	Building Permits MoM	10/26/2018	10:00 AM	U. of Mich. 1 Yr Inflation
10/10/2018	10:00 AM	Wholesale Trade Sales MoM	10/17/2018	2:00 PM	FOMC Meeting Minutes	10/26/2018	10:00 AM	U. of Mich. 5-10 Yr Inflation
10/11/2018	08:30 AM	CPI MoM	10/18/2018	09:45 AM	Bloomberg Economic Expectations	10/29/2018	08:30 AM	Personal Income
10/11/2018	08:30 AM	CPI Ex Food and Energy MoM	10/18/2018	09:45 AM	Bloomberg Consumer Comfort	10/29/2018	08:30 AM	Personal Spending
10/12/2018	10:00 AM	U. of Mich. 1 Yr Inflation	10/18/2018	10:00 AM	Leading Index	10/30/2018	09:00 AM	S&P CoreLogic CS US HPI NSA Index
10/12/2018	10:00 AM	U. of Mich. 5-10 Yr Inflation	10/19/2018	10:00 AM	Existing Home Sales	10/30/2018	09:00 AM	S&P CoreLogic CS US HPI YoY NSA
10/15/2018	08:30 AM	Retail Sales Advance MoM	10/19/2018	10:00 AM	Existing Home Sales MoM	10/30/2018	10:00 AM	Conf. Board Consumer Confidence
10/15/2018	08:30 AM	Empire Manufacturing	10/22/2018	08:30 AM	Chicago Fed Nat Activity Index	10/30/2018	10:00 AM	Conf. Board Present Situation
10/15/2018	08:30 AM	Retail Sales Ex Auto MoM	10/23/2018	10:00 AM	Richmond Fed Manufact. Index	10/30/2018	10:00 AM	Conf. Board Expectations
10/16/2018	4:00 PM	Total Net TIC Flows	10/24/2018	09:45 AM	Markit US Composite PMI	10/31/2018	07:00 AM	MBA Mortgage Applications
10/16/2018	4:00 PM	Net Long-term TIC Flows	10/24/2018	10:00 AM	New Home Sales	10/31/2018	08:15 AM	ADP Employment Change
10/17/2018	07:00 AM	MBA Mortgage Applications	10/24/2018	10:00 AM	New Home Sales MoM	10/31/2018	08:30 AM	Employment Cost Index

Sources: Bloomberg, Thomson Reuters and ICI. Unless otherwise noted, all data is presented as of September 28, 2018.

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