



Monthly Market Review

The Federal Reserve (Fed) is on the move, but the bond market? Not so much. While it is nearly certain that the Fed will raise short-term rates by 25 to perhaps 50 basis points (bps) in coming months, interest rates generally do not seem to reflect this, as strong counterforces have kept markets in check.

Economic Highlights

- Strong labor market conditions support Fed tightening. The U.S. economy added 201,000 new jobs in August, modestly beating expectations and in line with the average monthly job gains so far this year. The unemployment rate held at 3.9% for the month, while initial unemployment claims reached their lowest level since 1969.
- Wage growth, as measured by average hourly earnings, also supports Fed tightening. For the previous 12 months through August, wages increased by 2.9%, the fastest pace of growth since June 2009. The increase reinforced the upward trend of other general inflation measures, including the core personal consumption expenditures (PCE) index and the core consumer price index (CPI).
- The trade war clouds the horizon. While the immediate prospects for the U.S. economy are strong, central bankers and leaders of global businesses have begun to warn of the cumulative disruptive effects that could result from protracted trade battles with China, Europe and our nearby North American partners.
- Lagging growth in Europe and growing emerging market (EM) economic woes are counterbalancing U.S. growth momentum, with the interest rates of developed market countries well below those in the U.S., and many global stock markets in bear market territory.
- The Federal Open Market Committee (FOMC) left the overnight target rate of 1.75% to 2% unchanged at its August 1 meeting. At the annual Jackson Hole symposium, Fed Chairman Jay Powell reaffirmed the Fed's positive outlook for growth and employment in the U.S., while laying further groundwork for the Fed to continue on its current path of gradually raising rates.
- Thus, the disconnect: market participants expect another two Fed rate hikes in 2018, and an additional two to four hikes in 2019, which could bring the overnight rate to 3% or more, but 10-year U.S. Treasury rates remain well contained below this threshold level.

Bond Markets

- The U.S. Treasury yield curve twisted a bit over the month as short-term maturities (less than two years) rose, while longer-term maturities (beyond two years) fell modestly.
- The slope of the curve, as measured by the yield difference between 10- and two-year Treasury notes, ended August at 0.23%, just above the decade low of 0.19% reached intra-month.
- For total-return investors, the twisted, flatter yield curve resulted in longer-term securities outperforming their shorter-term counterparts over the month. For example, the three-month and

12-month Treasury indices returned 0.18% and 0.22%, respectively. Meanwhile, the three-year, five-year and 30-year constant maturity indices returned 0.43%, 0.75% and 1.75%, respectively.

- Investment-grade (IG) credit spreads were relatively unchanged for the quarter. As a result of the muted spread impact, outperformance in the credit sector over the month can largely be attributed to the incremental income offered in the sector relative to similar maturity Treasury securities.

Municipal Bond Market

- Municipal new issuance decreased in August by 12.9% to \$32.7 billion from \$37.5 billion the same month last year. Year-to-date (YTD) municipal new issuance is down 14.7% to \$224.8 billion in 2018 from \$263.5 billion during the same period last year, according to Municipal Market Monitor (TM3) data.
- August brought positive bond flows throughout the month, with inflows totaling \$2.3 billion, following July's net inflows of \$3.4 billion, according to Investment Company Institute (ICI) data.
- The Municipal Market Data (MMD) Index curve experienced rising rates across the front end of the curve in August. The one-year rate jumped 13 bps to 1.6%, while both the three-year and five-year rates increased 5 bps to 1.81% and 2.02%, respectively. The 10-year rate dipped 1 bp to 2.44%. On the long end, the 30-year rate moved up 1 bp to 3.02%, 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 August, Municipal/Treasury ratios increased throughout the yield curve. The two-year ratio climbed to 64.7% from 60.7% in July, and the five-year ratio increased to 73.7% from 69.2%. The intermediate-term ratio jumped to 78.9% from July's 74.9%, while the 10-year ratio rose to 85.6% from 82.7%. The 30-year ratio also increased to 100.7% from 97.6% a month earlier, according to TM3 data.
- The Municipal curve flattened in August, with the AAA MMD two-through 10-year slope ending at 74 bps, slightly narrower than July's 83 bps. The slope between the AAA MMD two-through 30-year narrowed to 132 bps from July's 139 bps.

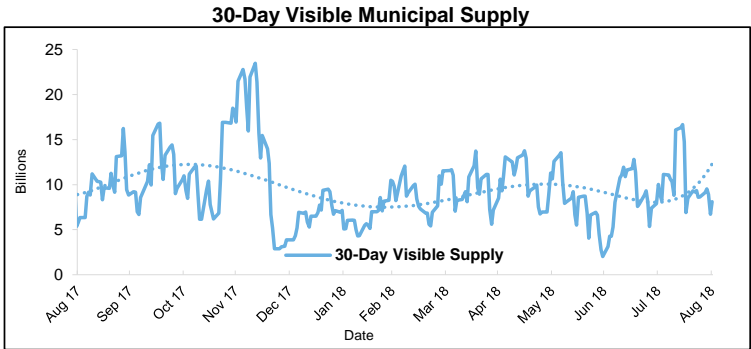
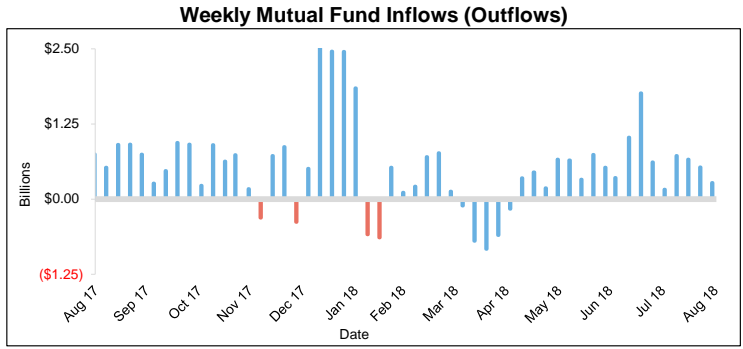
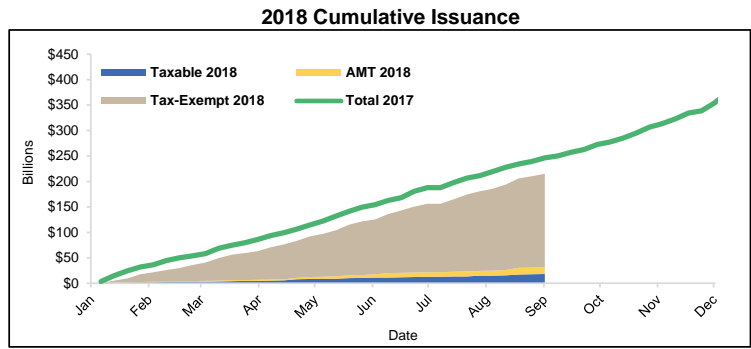
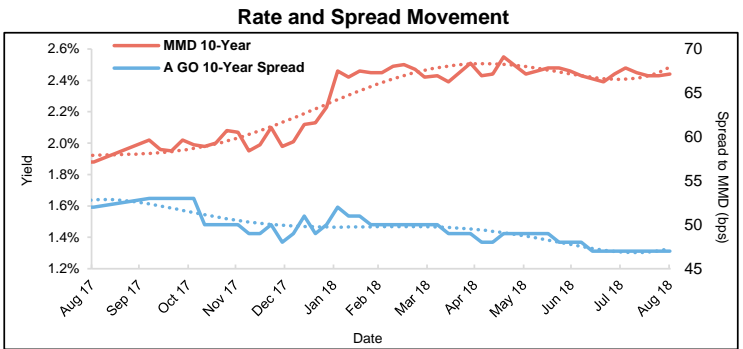
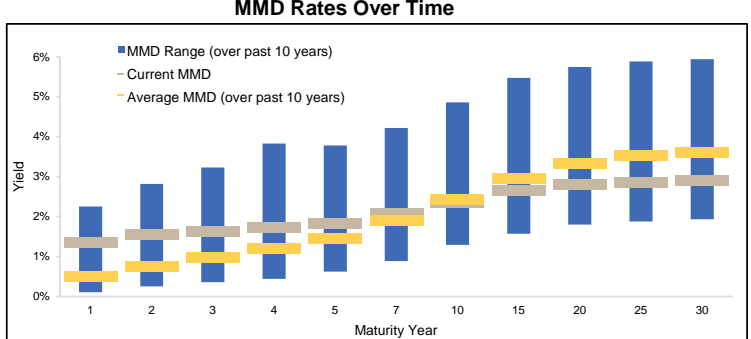
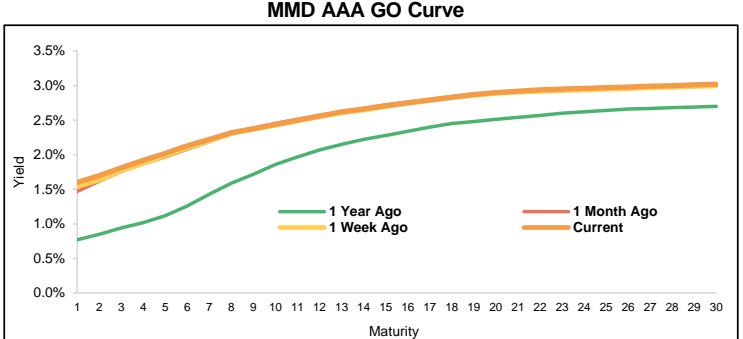
Recent News

- The SEC adopted amendments to enhance transparency in the municipal securities market. The modifications apply to Rule 15c2-12 of the Securities Exchange Act, adding two new reportable events focusing on material financial obligations that could impact an issuer's liquidity, overall creditworthiness or an existing security holder's rights.

| Spot Rates | | | | |
|------------|----------------------|-------------------------|--------------------------|-------------------------|
| | Current 8/31/2018 | 1 Week Ago 8/24/2018 | 1 Month Ago 7/31/2018 | 1 Year Ago 8/31/2017 |
| 2-Year | 1.70 | 1.64 | 1.62 | 0.85 |
| 3-Year | 1.81 | 1.77 | 1.76 | 0.94 |
| 5-Year | 2.02 | 1.99 | 1.97 | 1.12 |
| 7-Year | 2.22 | 2.20 | 2.19 | 1.43 |
| 10-Year | 2.44 | 2.43 | 2.45 | 1.86 |
| 30-Year | 3.02 | 3.00 | 3.01 | 2.70 |

| Change in Spot Rate (basis points) | | | |
|------------------------------------|-------------------------|--------------------------|-------------------------|
| | 1 Week Ago 8/24/2018 | 1 Month Ago 7/31/2018 | 1 Year Ago 8/31/2017 |
| 2-Year | 6 | 8 | 85 |
| 3-Year | 4 | 5 | 87 |
| 5-Year | 3 | 5 | 90 |
| 7-Year | 2 | 3 | 79 |
| 10-Year | 1 | -1 | 58 |
| 30-Year | 2 | 1 | 32 |

| Market Rates | | | |
|--------------|------------|---------------|----------------|
| Term | MMD AAA GO | U.S. Treasury | Muni Swap Rate |
| 2-Year | 1.70% | 2.63% | 1.92 |
| 3-Year | 1.81% | 2.69% | 2.00 |
| 5-Year | 2.02% | 2.74% | 2.08 |
| 7-Year | 2.22% | 2.81% | 2.16 |
| 10-Year | 2.44% | 2.86% | 2.24 |
| 30-Year | 3.02% | 3.02% | 2.50 |



| Economic Calendar | | | | | |
|-------------------|----------|-------------------------------------|------------|----------|---------------------------------|
| Date | Time | Statistic | Date | Time | Statistic |
| 09/14/2018 | 08:30 AM | Retail Sales Ex Auto MoM | 09/18/2018 | 04:00 PM | Net Long-term TIC Flows |
| 09/14/2018 | 08:30 AM | Retail Sales Ex Auto and Gas | 09/19/2018 | 07:00 AM | MBA Mortgage Applications |
| 09/14/2018 | 08:30 AM | Retail Sales Control Group | 09/19/2018 | 08:30 AM | Current Account Balance |
| 09/14/2018 | 08:30 AM | Import Price Index ex Petroleum MoM | 09/19/2018 | 08:30 AM | Housing Starts MoM |
| 09/14/2018 | 08:30 AM | Import Price Index YoY | 09/19/2018 | 08:30 AM | Building Permits |
| 09/14/2018 | 08:30 AM | Export Price Index MoM | 09/19/2018 | 08:30 AM | Building Permits MoM |
| 09/14/2018 | 09:15 AM | Industrial Production MoM | 09/20/2018 | 08:30 AM | Initial Jobless Claims |
| 09/14/2018 | 09:15 AM | Capacity Utilization | 09/20/2018 | 08:30 AM | Continuing Claims |
| 09/14/2018 | 09:15 AM | Manufacturing (SIC) Production | 09/20/2018 | 09:45 AM | Bloomberg Economic Expectations |
| 09/14/2018 | 10:00 AM | U. of Mich. Sentiment | 09/20/2018 | 10:00 AM | Leading Index |
| 09/14/2018 | 10:00 AM | U. of Mich. Current Conditions | 09/20/2018 | 10:00 AM | Existing Home Sales |
| 09/14/2018 | 10:00 AM | U. of Mich. Expectations | 09/20/2018 | 10:00 AM | Existing Home Sales MoM |
| 09/14/2018 | 10:00 AM | U. of Mich. 5-10 Yr Inflation | 09/21/2018 | 09:45 AM | Markit US Manufacturing PMI |
| 09/17/2018 | 08:30 AM | Empire Manufacturing | 09/21/2018 | 09:45 AM | Markit US Services PMI |
| 09/18/2018 | 10:00 AM | NAHB Housing Market Index | 09/21/2018 | 09:45 AM | Markit US Composite PMI |
| 09/24/2018 | 10:30 AM | Dallas Fed Manf. Activity | | | |
| 09/25/2018 | 09:00 AM | FHFA House Price Index MoM | | | |
| 09/25/2018 | 09:00 AM | S&P CoreLogic CS 20-City MoM SA | | | |
| 09/25/2018 | 09:00 AM | S&P CoreLogic CS 20-City NSA Index | | | |
| 09/25/2018 | 09:00 AM | S&P CoreLogic CS US HPI NSA Index | | | |
| 09/25/2018 | 09:00 AM | S&P CoreLogic CS US HPI YoY NSA | | | |
| 09/25/2018 | 10:00 AM | Conf. Board Consumer Confidence | | | |
| 09/25/2018 | 10:00 AM | Conf. Board Present Situation | | | |
| 09/25/2018 | 10:00 AM | Conf. Board Expectations | | | |
| 09/26/2018 | 10:00 AM | New Home Sales | | | |
| 09/26/2018 | 10:00 AM | New Home Sales MoM | | | |
| 09/26/2018 | 02:00 PM | FOMC Rate Decision (Upper Bound) | | | |
| 09/27/2018 | 08:30 AM | Advance Goods Trade Balance | | | |
| 09/27/2018 | 08:30 AM | Wholesale Inventories MoM | | | |
| 09/27/2018 | 08:30 AM | GDP Annualized QoQ | | | |

Sources: Bloomberg, Thomson Reuters and ICI. Unless otherwise noted, all data is presented as of August 31, 2018.

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