Monthly Market Review

Growth surges in the second quarter, but will it last amid trade wars, a slowing housing market and more Federal Reserve (Fed) rate hikes?

Economic Highlights

- The first estimate for second-qua ter gross domestic product (GDP) growth breached 4% for the first time since the third qua ter of 2014. A strong rebound in consumer spending, sustained business investment, strong federal government defense spending and a surge in exports (in large part due to accelerated soybean exports to China ahead of tariffs) boosted economic xpansion to a 4.1% annual rate.
- The trade war expanded as the Trump administration continues to threaten significant increases in tariffs on imp ts, the latest iteration being an increase from 10% to 25% on $200 billion of Chinese imports. Not unexpectedly, China threatened retaliatory countermeasures.
- As expected, the Federal Open Market Committee (FOM) le rates unchanged at its August 1 meeting. However, the post-meeting statement confirmed a li ely September rate hike with more hikes to follow. The Fed upgraded its assessment of U.S. economic activity and household spending to "strong."
- Across the pond, Eurozone GDP slowed further in the second quarter after a weak first qu ter. Rising inflation, falling consume sentiment and a strengthening U.S. dollar (USD) weighed on consumer spending in the region. In a surprisingly unanimous decision, the Bank of England raised its benchmark interest rate for only the second time in a decade, as inflation worries trumpe concerns about Brexit.
- U.S. employment conditions remain positive. Despite headline job growth that missed expectations in July (157,000 versus 193,000), upward revisions to prior months make a 215,000 monthly average pace this year and confirm a robust labor mar et. The unemployment rate ticked lower to 3.9% in July, while average hourly earnings held steady at 2.7% year over year (YoY).
- Robust consumer spending contributed to building price pressures in the U.S. The consumer price index (CPI) rose 2.9% in the 12 months ending in June versus just 1.6% a year ago. The core personal consumption expenditures price index – the Fed's favorite inflation measure – rose modestly in June to 1. % YoY. Expectations remain anchored around the Fed's 2% target.

Bond Markets

- U.S. Treasury yields kicked off the third qua ter by increasing across all maturities. The two-year Treasury rose the most, increasing by 14 basis points (bps) (0.14%) from 2.53% to 2.67% over the month. The yield curve remained near its flattest level in more than a decad
- For total return investors, shorter-term maturities generally did better in Jul , as higher yields pushed the majority of Treasury benchmarks negative for the month (the exceptions being the shortest indices). For example, the three-month and 12-month Treasury indices returned 0.16% and 0.13%, respectively. Meanwhile, the three-year, 10-year and 30-year constant maturity Treasury indices fell 0.18%, 0.72% and 1.65%, respectively.
- Investment-grade credit spreads narrowed during July, benefitin returns in the corporate sector.
- Mortgage-backed securities (MBS) returns also outperformed Treasury benchmarks, though by smaller amounts, helped by low market volatility.

Equity Markets

- The S&P 500 (S&P) index charged ahead during the month, pumping out a 3.7% total return, as corporate earnings were strong. Smaller stocks and the tech industry generally led the way.
- Sector performance within the S&P was positive across the board, with all of the 11 sectors posting positive returns in July. Industrials, Healthcare, and Financials led with 7.32%, 6.61% and 5.27%, respectively. Real Estate, Energy and Consumer Discretionary lagged during the month, returning 1.08%, 1.42%, and 1.83%, respectively.
- Following a rapid ascent over the past five months, the U D (DYX) index moved sideways through July. The trade war and headwinds for Eurozone growth continued to weigh on regional currencies and helped buoy the USD.

PFM Outlook

- On the heels of economic strengths (GDP, job growth, consumption, rising inflation), we believe the Fed will maintain its gradual, but sustained pace of further hikes to the federal funds target rate later this year. As a result, we will continue to position portfolios with a modestly short and conservative duration bias relative to benchmarks.
- Federal agency yield spreads relative to U.S. Treasury securities widened ever so slightly in July, but remain historically narrow. The recent backup in spreads may present opportunities in certain maturities. Limited upcoming supply is expected to be a positive for the sector.
- We continue to look to credit to add to returns, as healthy fundamentals and strong earnings support allocations to corporate securities. But we prefer market-weight allocations (a modestly defensive posture relative to our recent overweight) and companies with strong capital positions as the economy enters the later phase of a long expansion cycle and responds to potential looming headwinds from trade wars, increased leverage and geopolitical uncertainty.
- Agency MBS are another vehicle to add incremental income, compared with government obligations, without taking credit risk, though security selection is vital as they add interest rate risk to a portfolio.
- AAA-rated ABS and high-quality negotiable certificates of deposit (CDs) offer a more defensive xposure to credit allocations. As a result, we have shifted our credit emphasis to se tors we view as lower-risk.
- Increasing short-term rates continue to benefit cash, shorter-term and stable net asset value investors. Today's flat yield also means buyers of short-duration credit instruments, such as commercial paper (CP) and floating-rate notes, may be able to capture yields comparable to longer-maturity government securities, but with less interest rate risk.
- The Fed rate hike in coming months has boosted money market rates well into the 2% range and, as bank deposit rates have lagged, short-term Treasuries, CP and negotiable CDs are quite attra tive for liquid funds.

U.S. Treasury Yields

Maturity	Jul 31, 2017	Jun 30, 2018	Jul 31, 2018	Monthly Change
3 Month	1.08%	1.92%	2.02%	0.10%
6 Month	1.13%	2.11%	2.19%	0.08%
2 Year	1.35%	2.53%	2.67%	0.14%
5 Year	1.84%	2.74%	2.85%	0.11%
10 Year	2.30%	2.86%	2.96%	0.10%
30 Year	2.90%	2.99%	3.08%	0.09%

Yields by Sector and Maturity as of July 31, 2018

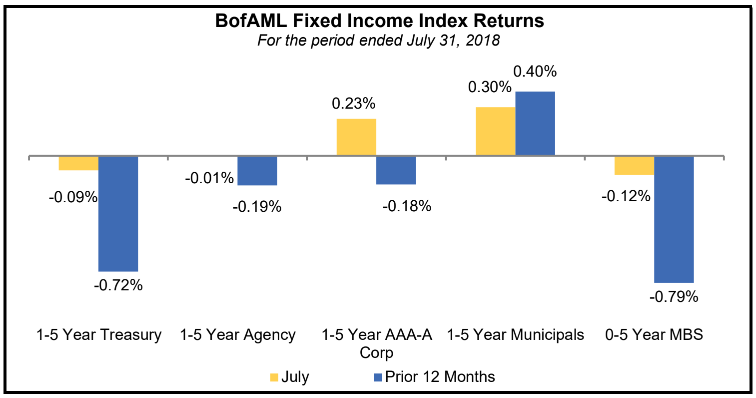
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3 Month	2.02%	1.97%	2.51%	-
6 Month	2.19%	2.09%	2.59%	-
2 Year	2.67%	2.73%	3.06%	1.63%
5 Year	2.85%	2.97%	3.42%	1.95%
10 Year	2.96%	3.24%	3.85%	2.43%
30 Year	3.08%	3.37%	4.20%	3.03%

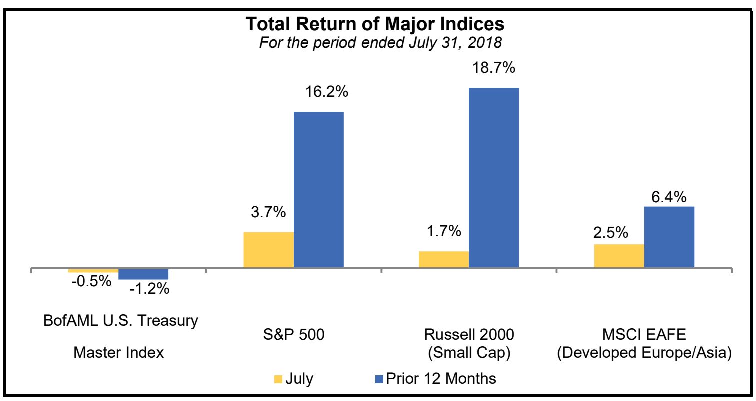
Spot Prices and Benchmark Rates

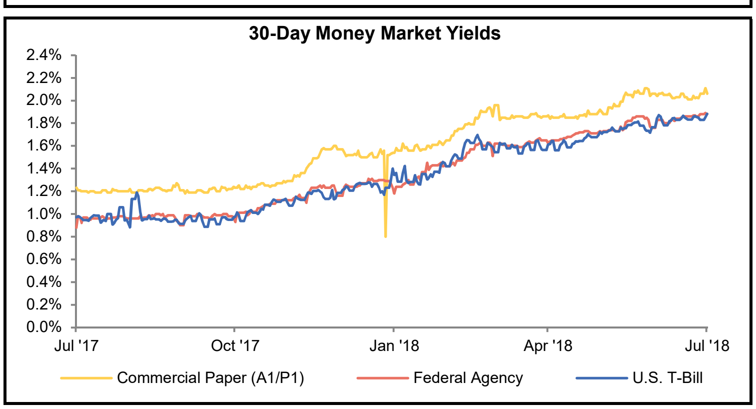
Index	Jul 31, 2017	Jun 30, 2018	Jul 31, 2018	Monthly Change
1 Month LIBOR	1.23%	2.09%	2.08%	-0.01%
3 Month LIBOR	1.31%	2.34%	2.35%	0.01%
Effective Fed Funds Rate	1.07%	1.91%	1.91%	0.00%
Fed Funds Target Rate	1.25%	2.00%	2.00%	0.00%
Gold ($/oz)	$1,267	$1,255	$1,224	-$31
Crude Oil ($/Barrel)	$50.17	$74.15	$68.76	-$5.39
U.S. Dollars per Euro	$1.18	$1.17	$1.17	$0.00

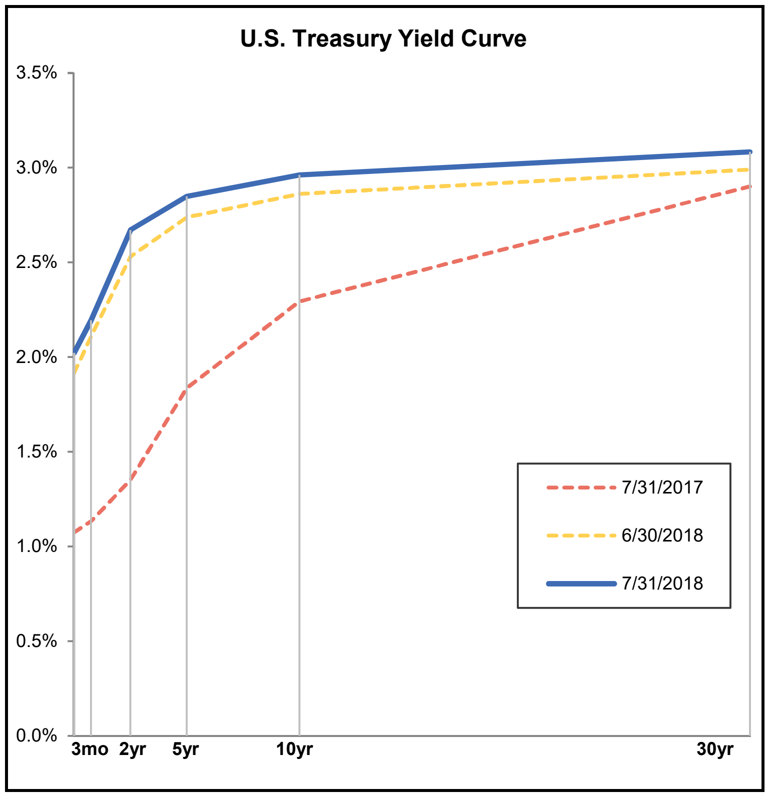
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Nonfarm Payrolls	3-Aug	Jul	157k	193k
CPI ExFood&Energy YoY	12-Jul	Jun	2.3%	2.3%
Retail Sales MoM	16-Jul	Jun	0.5%	0.5%
Consumer Confidence	31-Jul	Jul	127.4	126.0
GDP Annualized QoQ	27-Jul	2Q	4.1%	4.2%
New Home Sales MoM	25-Jul	Jun	-5.3%	-3.1%
FOMC Rate Dec. (Upper)	1-Aug	Aug	2.00%	2.00%









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