Monthly Market Review

The trade war is officially on. Now it's a question of whether the strong fiscal stimulus that is fueling the U.S. economy will be enough to overcome the drag of trade uncertainty until cooler heads prevail.

Economic Highlights

- Federal tax cuts and expanded federal spending accelerated the pace of growth in the second quarter. This was reflected in predictions for robust growth of gross domestic product (GDP). Some forecasters believe GDP will come in at 4% or more after a disappointing 2% in the first quarter.
- Labor market conditions remained positive as the economy added 213,000 jobs in June. The average for the second quarter was 211,000; above the level that is normally required to absorb new entrants into the job market. The unemployment rate ticked slightly higher, from 3.8% to 4.0%, a result of labor force expansion, as increased optimism brought job seekers into the market and the labor force participation rate increased.
- This strength led the Federal Open Market Committee (FOMC) to tighten monetary policy again at its June meeting by increasing the overnight federal funds target rate by a quarter of a percentage point to a new range of 1.75% to 2.00%, even as most FOMC members warned of the potential increased risks posed by trade policy.
- On the price front, inflation measures are trending somewhat higher than May's and above the Federal Reserve's (Fed) target of 2%. For example, the year-over-year (YoY) increase in the personal consumption expenditure (PCE) price index, a favored Fed measure, rose in May by 2.3%. The strong job market and inflation above the minimum desired by the Fed, along with the potential for trade policies to boost prices further, could lead the Fed to raise the overnight rate higher in coming months.

Bond Markets

- Despite a rise in the federal funds rate, long-term Treasury yields declined in June, with the 30-year bond ending the month at a yield of 2.99%, down four basis points (bps) (0.04%). Meanwhile, maturities in the one- to five-year range increased by four to 10 bps, furthering the trend toward a flat yield curve.
- As a result, both short- and long-term indices outperformed their intermediate maturity counterparts. For example, the six-month Treasury index returned 0.16% for the month and the 30-year Treasury index returned 0.29%, while the one- to five-year Treasury index returned -0.01% for the month.
- Investment grade credit spreads widened through June, largely on global trade tensions, European uncertainty and weaker demand. Although the corporate sector now offers the most incremental income when compared with government securities for more than a year, the spread widening generally resulted in corporate bonds underperforming comparable duration Treasuries on a total return basis.

Equity Markets

- Despite the uptick in volatility during June and the resurgence of worldwide economic headwinds, the Standard & Poor's 500 (S&P) index eked out a positive total return of 0.62% for the month. Year to date (YTD), the domestic equity index is up 2.65%.
- Sector performance within the S&P was generally positive, with eight of the 11 sectors posting positive returns. Consumer Staples, Real Estate and Consumer Discretionary led gains, returning 4.50%, 4.44% and 3.61%, respectively. Industrials, Financials and Information Technology were the losing sectors during the month of June, returning -3.31%, -1.92% and -0.35%, respectively.
- The U.S. Dollar Index (DYX) once again climbed higher through June, marking the third consecutive month of increase. The modest gain was attributed to further weakness of the Euro and British Pound, which together account for nearly 70% of the DYX. Political uncertainty in Italy and Germany, ongoing Brexit negotiations and an emerging trade war with the U.S. are weighing on growth prospects in Europe.

PFM Outlook

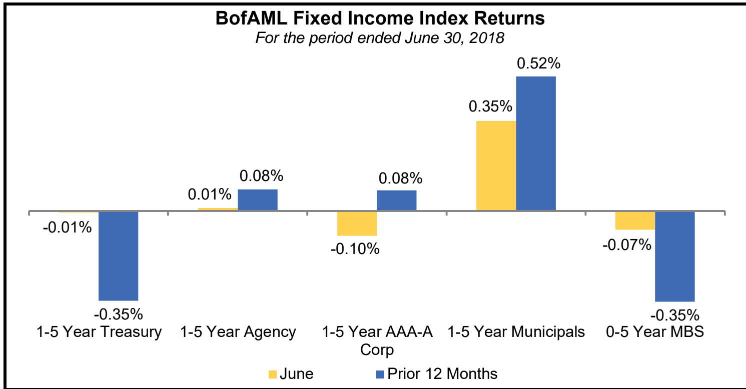
- Given the strength of the U.S. economy, we expect the Fed to hike rates at least once more this year. New tariffs on imported goods could put further pressures on U.S. prices in the short run, thus supporting the Fed's action. As such, we believe a modestly defensive duration position continues to be warranted for at least the near term. Longer term, however, trade policies could become a drag on the U.S. and global economies, and the Fed might be compelled to alter its policies.
- Our view in the near term is that the credit sector offers value as economic and earnings growth balance the increase in corporate debt levels that we have observed. However, the sector would be among the first to feel adverse effects from trade policies and related geopolitical risk. As a result, we believe a modestly defensive posture is warranted. We prefer market-weight allocations to corporates, with a preference for AAA-rated Asset-Backed Securities (ABS) and negotiable certificates of deposit (CDs), which offer an element of diversification and downside protection in credit sectors.
- By contrast, federal agency yields remain very close to matched-maturity Treasuries, for the most part, and offer little opportunity. One exception is longer maturity Tennessee Valley Authority debt securities (TVAs), where yield spreads widened on the Trump administration's proposal to privatize the agency.
- Supranationals remain a good alternative to agencies. Despite light issuance over the past few months, as expected seasonally, supranational yield spreads were generally unchanged over the month, with some areas of the curve modestly wider.
- 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, commercial paper and negotiable CDs are quite attractive for liquid funds.

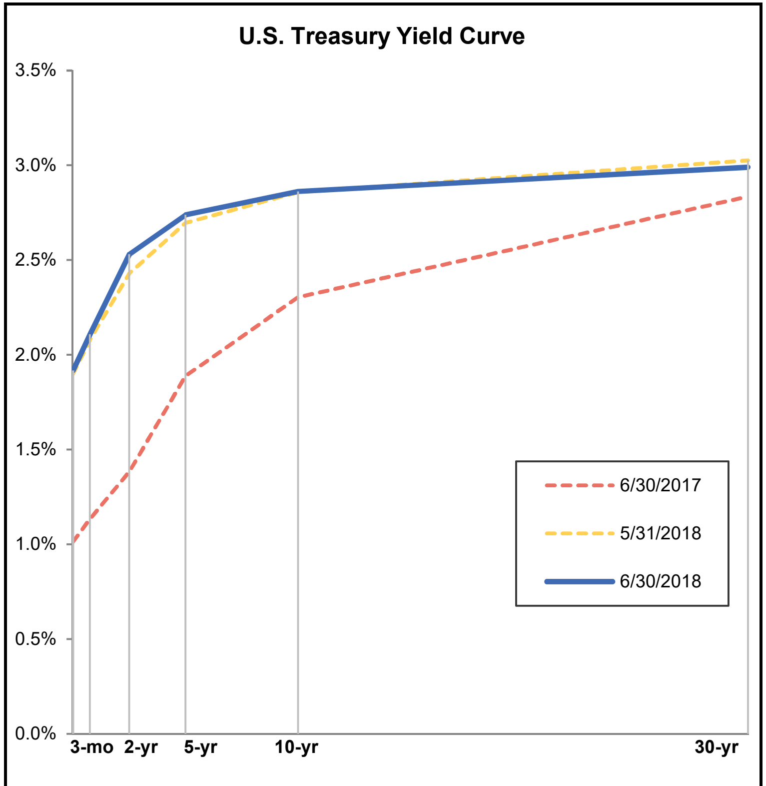
U.S. Treasury Yields				
Maturity	Jun 30, 2017	May 31, 2018	Jun 30, 2018	Monthly Change
3-Month	1.01%	1.90%	1.92%	0.02%
6-Month	1.13%	2.08%	2.11%	0.03%
2-Year	1.38%	2.43%	2.53%	0.10%
5-Year	1.89%	2.70%	2.74%	0.04%
10-Year	2.31%	2.86%	2.86%	0.00%
30-Year	2.84%	3.03%	2.99%	-0.04%

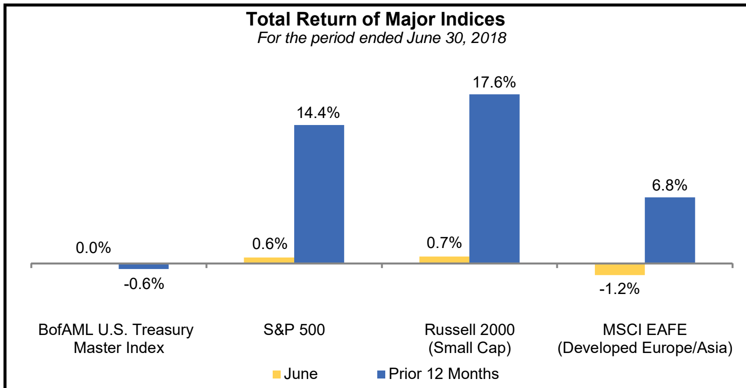
Yields by Sector and Maturity as of June 30, 2018				
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	1.92%	1.90%	2.48%	-
6-Month	2.11%	1.97%	2.56%	-
2-Year	2.53%	2.59%	2.99%	1.64%
5-Year	2.74%	2.85%	3.38%	1.97%
10-Year	2.86%	3.14%	3.85%	2.40%
30-Year	2.99%	3.24%	4.26%	2.98%

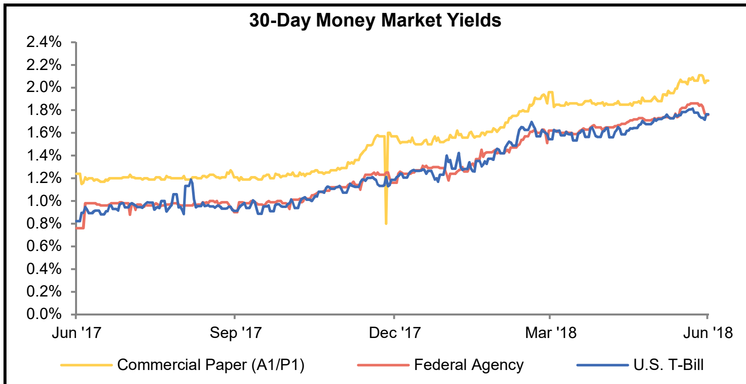
Spot Prices and Benchmark Rates				
Index	Jun 30, 2017	May 31, 2018	Jun 30, 2018	Monthly Change
1-Month LIBOR	1.22%	2.00%	2.09%	0.09%
3-Month LIBOR	1.30%	2.32%	2.34%	0.02%
Effective Fed Funds Rate	1.06%	1.70%	1.91%	0.21%
Fed Funds Target Rate	1.25%	1.75%	2.00%	0.25%
Gold ($/oz)	$1,242	$1,300	$1,255	-$46
Crude Oil ($/Barrel)	$46.04	$67.04	$74.15	$7.11
U.S. Dollars per Euro	$1.14	$1.17	$1.17	$0.00

Economic Indicators				
Indicator	Release Date	Period	Actual	Survey (Median)
Nonfarm Payrolls	6-Jul	Jun	213k	195k
CPI ExFood&Energy YoY	12-Jun	May	2.2%	2.2%
Retail Sales MoM	14-Jun	May	0.8%	0.4%
Consumer Confidence	26-Jun	Jun	126.4	128.0
GDP Annualized QoQ	28-Jun	1Q	2.0%	2.2%
New Home Sales MoM	25-Jun	May	6.7%	0.8%
FOMC Rate Dec. (Upper)	13-Jun	Jun	2.00%	2.00%









Source: Bloomberg. Data as of June 30, 2018, unless otherwise noted.

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