Monthly Market Review

Economic Highlights

- Bond returns for the first half of the year were strong. Equity returns were even stronger. The recent trend of rising bond prices AND rising stock prices in the face of declining economic growth, a weaker outlook for corporate earnings, and rising trade tensions doesn't match the usual pattern of market behavior. Something will eventually have to give. But what?
- The Federal Reserve (Fed) held short-term rates unchanged in June at the current target range of 2.25% to 2.50%. Fed Chair Jerome Powell acknowledged risks to the Fed's positive outlook that included: ongoing trade disputes, global growth concerns, a messy Brexit, recent declines in business sentiment and investment, and increased risk of falling inflation. In light of these rising uncertainties, Powell said the Fed will "act as appropriate to sustain the expansion." The market now widely expects two or three Fed rate cuts in the second half of 2019, with the first cut expected at the end of July.
- The final release of first quarter U.S. gross domestic product showed growth unchanged at a 3.1% annual rate and continues to signal a seemingly resilient U.S. economy. While growth concerns are focused abroad, most notably in the Eurozone and China, they have yet to spill over to our domestic shores just yet.
- All eyes, including those of Fed policy makers, are on lackluster inflation. The Consumer Price Index (CPI) indicates inflation near 2%, but the Fed's preferred inflation gauge – the Personal Consumption Expenditure (PCE) Price Index – has risen only 1.6% over the past year. Soft inflation readings will give the Fed room to ease monetary conditions without the worry of an inflation spike.
- The June jobs report showed strength in the labor market. The economy added 224,000 new jobs in June, outpacing expectations and bouncing back from disappointing growth of only 75,000 jobs in May. The unemployment rate ticked slightly higher to 3.7% as the labor force participation rate also increased 10 basis points (bps) to 62.9%.

Bond Markets

- U.S. Treasury yields declined across the entire curve in June, with maturities under a year falling more (down 20 to 25 bps) than those between one and 10 years (down 10 to 15 bps). Short-term yields are closely tied to the expected near-term cut in the fed funds rate.
- As a result, the spread between 10-year and 3-month Treasury securities shifted modestly, but the yield curve remains inverted out to 10 years.
- Most U.S. Treasury maturities ended the quarter near 18-month lows, driving strong monthly, quarterly and year-to-date bond market returns. Longer-duration strategies benefit most. For example, the 1-year and 2-year Constant Maturity U.S. Treasury Indices returned 0.40% and 0.51%, respectively, for the month. Meanwhile, the 5-year and 10-year indices generated returns of 1.00% and 1.44%, respectively.
- Credit spreads narrowed in June after a temporary widening in May. This led corporate sector returns to outpace Treasury returns by a solid margin.

Equity Markets

- U.S. equities rebounded in full throttle in June as the market embraced upcoming Fed accommodation. Over the month, the S&P 500 popped 7.0% to new all-time record highs, while the Dow Jones Industrial Average was up 7.3% and the NASDAQ climbed 7.5%.
- The U.S. Dollar Index (DXY), measured against a basket of international currencies, fell slightly in June (-0.6%), but is well above (+8.5%) the 3-year low reached in the first quarter of 2018.

PFM Outlook

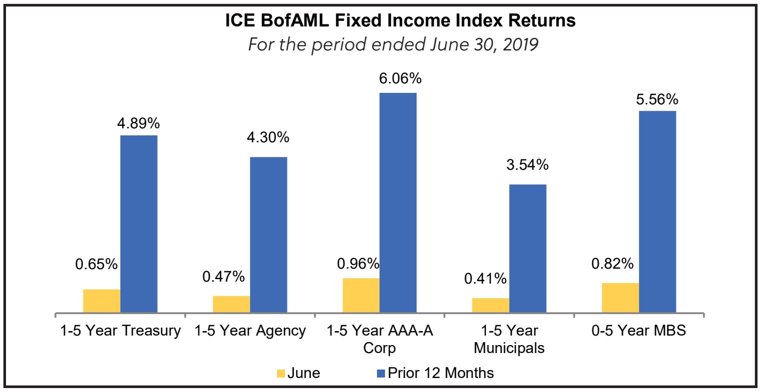
- In light of the Fed's current stance on monetary policy and the general outlook that yields are more likely to fall over the near term, we will continue to maintain portfolio durations in line with benchmarks. Despite the inverted yield curve, a neutral duration strategy helps reduce the risk of underperforming benchmarks in the event yields continue to fall.
- The federal agency and supranational sectors offer little incremental income and modest potential for incremental returns compared to Treasuries. Spreads are narrow and issuance is light, as it has been all year.
- Investment-grade (IG) corporates generated strong positive excess returns in June, following a weak May. The sector is the clear top performer year-to-date across all maturities and rating classes. Our fundamental sector outlook remains favorable and a dovish Fed supports the relative performance in credit sectors.
- Propelled by plummeting Treasury yields, which have heightened expectations for a surge in prepayments, the mortgage-backed securities (MBS) sector underperformed Treasuries in the second quarter. Looking ahead, increased prepays, the Fed's ongoing decrease to their MBS balance sheet reinvestment program, and increased seasonal supply may weigh on the sector. Nonetheless, the sector's recent underperformance has widened spreads to more attractive levels.
- Expected rate cuts by the Fed have pushed money market yields lower and the sector has also been impacted by narrowing credit spreads that have depressed relative yields in credit-backed instruments. The best value today is in very short maturities (including overnight repurchase agreements) but this is not with risk as actual Fed action will immediately affect these maturities. We recommend laddering investments to meet cash flows in the 1-12 month area.

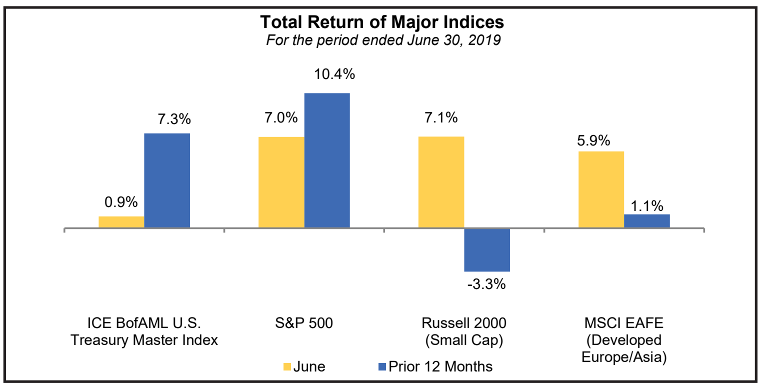
U.S. Treasury Yields				
Duration	June 30, 2018	May 31, 2019	June 30, 2019	Monthly Change
3-Month	1.92%	2.34%	2.09%	-0.25%
6-Month	2.11%	2.35%	2.10%	-0.25%
2-Year	2.53%	1.92%	1.76%	-0.16%
5-Year	2.74%	1.91%	1.77%	-0.14%
10-Year	2.86%	2.13%	2.01%	-0.12%
30-Year	2.99%	2.57%	2.53%	-0.04%

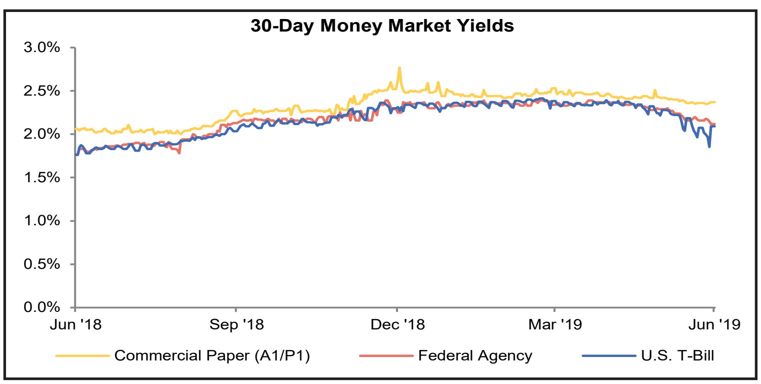
Yields by Sector and Maturity as of June 30, 2019				
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	2.09%	2.04%	2.16%	--
6-Month	2.10%	1.93%	2.18%	--
2-Year	1.76%	1.85%	2.22%	1.35%
5-Year	1.77%	1.88%	2.35%	1.46%
10-Year	2.01%	2.25%	2.79%	1.83%
30-Year	2.53%	2.73%	3.62%	2.48%

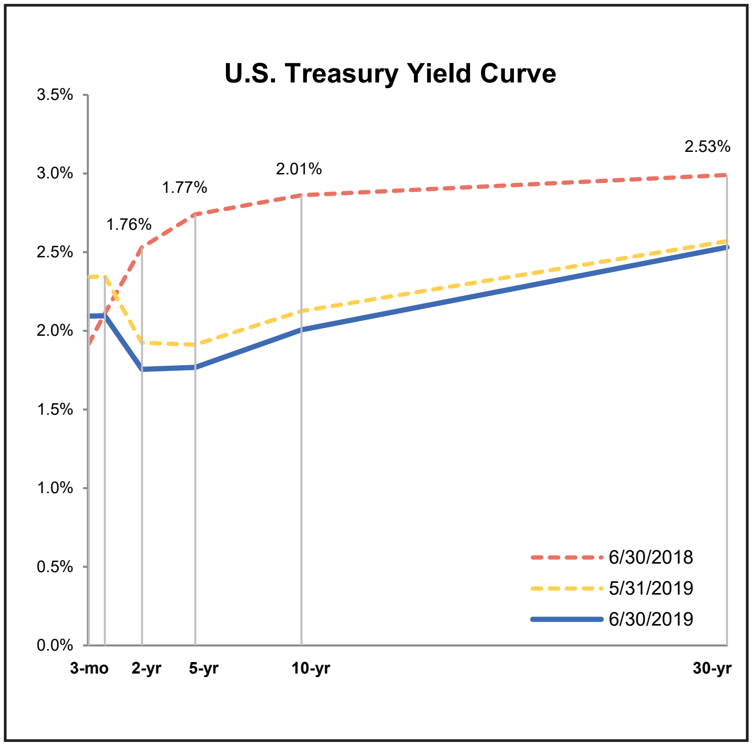
Spot Prices and Benchmark Rates				
Index	June 30, 2018	May 31, 2019	June 30, 2019	Monthly Change
1- Month LIBOR	2.09%	2.43%	2.40%	-0.03%
3- Month LIBOR	2.34%	2.50%	2.32%	-0.18%
Effective Fed Funds Rate	1.91%	2.40%	2.40%	0.00%
Fed Funds Target Rate	2.00%	2.50%	2.50%	0.00%
Gold ($/oz)	$1,255	$1,306	$1,414	$108
Crude Oil ($/Barrel)	$74.15	$53.50	$58.47	$4.97
U.S. Dollars per Euro	$1.17	$1.12	$1.14	$0.02

Economic Indicators				
Indicator	Release Date	Period	Actual	Survey (Median)
Retail Sales MoM	14-Jun	May	0.5%	0.6%
New Home Sales MoM	25-Jun	May	-7.8%	1.6%
Consumer Confidence	25-Jun	Jun	121.5	131
GDP Annualized QoQ	27-Jun	1Q T	3.1%	3.2%
ISM Manufacturing	1-Jul	Jun	51.7	51.0
Nonfarm Payrolls	5-Jul	Jun	224k	160k
Unemployment Rate	5-Jul	Jun	3.7%	3.6%









Source: Bloomberg. Data as of June 30, 2019, unless otherwise noted.