Monthly Market Review

pfm

Oh for the halcyon days of summer when stocks hit record highs, corporate profits surged, the U.S. economy was firing on all cylinders and the path for interest rates seemed clear.

Economic Highlights

- While underlying economic conditions in the U.S. remain favorable, a combination of uncertainties – U.S. politics, the ongoing trade war with China and a wavering U.S. central bank, slowing global growth, failing Brexit implementation and protests on the streets of Paris – have resulted in a significant stock market correction, surging credit spreads and a partial yield curve inversion.
- Volatility hit the bond markets as U.S. Treasury yields ranged over 40 basis points (bps) (0.4%) in November, and the yield curve inverted between two- and five-year maturities in early December for the first time since 2006. This curve dynamic is potentially an ominous warning sign amid slowing global growth. The question remains: Is a recession on the horizon?
- Federal Reserve (Fed) Chairman Jerome Powell's November speech at the Economic Club of New York took a dovish tone. With an unemployment rate of 3.7% and inflation near the Fed's 2% target, Powell opined that the U.S. economy is close to the Fed's dual objectives of "promoting maximum employment and price stability." Most notably though, he commented that "Interest rates . . . remain just below the broad range of estimates of the level that would be neutral for the economy." This was a significant change from his comments in October that the Fed was "a long way from neutral," and hinted that the pace of future Fed rate hikes may slow in the coming quarters.
- The outlook for economic expansion, measured by gross domestic product, has softened globally. Yet the U.S. labor market remains strong, adding 155,000 new jobs in November (well below expectations), the unemployment rate unchanged at 3.7%, wage growth steady at 3.1% year over year (YoY) and forward inflation rates at or near the Fed's 2% target.

Bond Markets

- The flattening of the U.S. Treasury yield curve is driven by the continued rise in short-term yields (driven by the expectation for near-term Fed tightening), while longer yields declined (will the economy slow to the point of recession?). For example, the yield on three- to 12-month Treasury bills increased less than 5 bps over the month. Meanwhile, yields on Treasury maturities beyond two years declined between 10 and 15 bps.
- As a result, longer-duration fixed-income indices generated solid performance relative to their shorter counterparts. Two-year Treasury benchmarks returned 2.79%; 10-year benchmarks returned 2.99% for the month. Nevertheless, the return on the broad Bloomberg Barclays U.S. Aggregate bond index is still negative for the year.

Equity Markets

- From its record closing high of 2,931 on September 20, the S&P 500 Index (S&P) closed out November at 2,760 – a decline of 5.8%. Further declines ensued in early December.
- Non-U.S. equity markets, represented by the MSCI ACWI ex-U.S. Index, ended the month up 0.95%. Developed markets, represented by the MSCI EAFE Index, finished down -0.13%, while emerging markets (EM), represented by the MSCI Emerging Markets Index, returned 4.12% in November.

PFM Outlook

- Many investors now think that the Fed is close to the end of its tightening strategy, implying that portfolio durations could be lengthened. On the other hand, the drag of widening credit spreads is amplified in long-duration investments, and U.S. economic fundamentals point to continued slow expansion. All of this leads us to maintain a modestly defensive duration position, at least for the near term.
- In the face of global risk-off sentiment, corporate debt battled a second consecutive month of significant spread widening – now at the widest spread levels since 2016. As a result, it was the worst-performing sector for the month. As corporate debt is expected to remain under pressure in the near term – mostly due to global growth concerns, lower oil prices, and looming tariff impacts – we plan to remain modestly defensive, reducing allocations and shortening durations in the sector. At the same time, wider spreads may present opportunities on an issuer-specific basis.
- Mortgage-backed securities (MBS) returns for most of the year have been underwhelming. Preference for shorter-term collateral and mid- to high-coupon structures helps combat extension and interest rate risks. With Fed balance sheet holdings in MBS set for more significant reduction over the next quarter, new purchases will be limited and selective.
- AAA-rated asset-backed securities (ABS) were not immune to the general risk-related spread widening over the month, though the change was less than for other credit sectors. Despite the modest spread widening, the ABS sector generated positive excess returns and continues to offer incremental yields with a defensive bias. We plan to continue to overweight ABS.
- With yields over 2%, money market funds and ultra-short-term fixed-income investments have been among the best performers year to date (YTD). Following a nearly six-month narrowing of commercial paper spreads, recent upticks in three-month LIBOR have pushed short-term credit spreads wider and presented good investment opportunities for short-term investors.

U.S. Treasury Yields

Maturity	Nov 30, 2017	Oct 31, 2018	Nov 30, 2018	Monthly Change
3-Month	1.26%	2.33%	2.35%	0.02%
6-Month	1.44%	2.49%	2.52%	0.03%
2-Year	1.78%	2.87%	2.79%	-0.08%
5-Year	2.14%	2.98%	2.81%	-0.17%
10-Year	2.41%	3.14%	2.99%	-0.15%
30-Year	2.83%	3.39%	3.29%	-0.10%

Yields by Sector and Maturity as of November 30, 2018

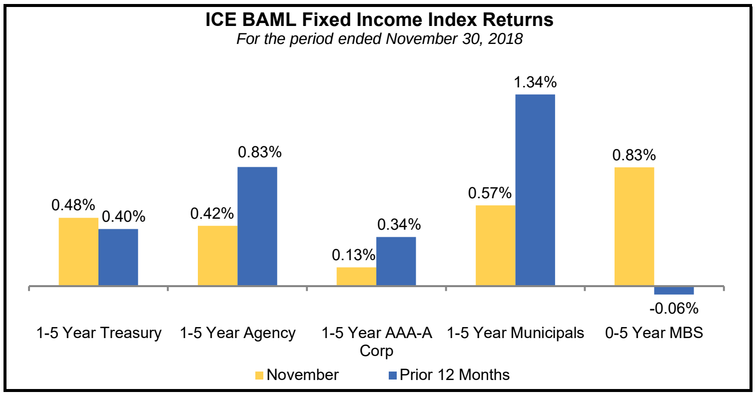
Maturity	U.S. Treasury	Federal Agency	Corporates-A Industrials	AAA Municipals
3-Month	2.35%	2.35%	2.80%	-
6-Month	2.52%	2.49%	2.87%	-
2-Year	2.79%	2.87%	3.29%	1.90%
5-Year	2.81%	2.99%	3.56%	2.19%
10-Year	2.99%	3.30%	3.96%	2.64%
30-Year	3.29%	3.61%	4.51%	3.28%

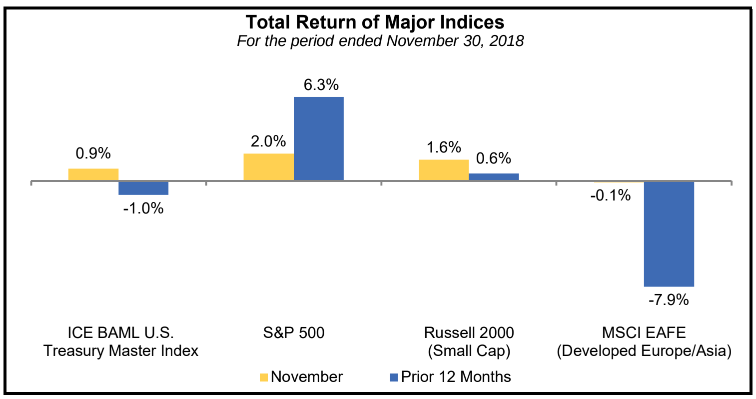
Spot Prices and Benchmark Rates

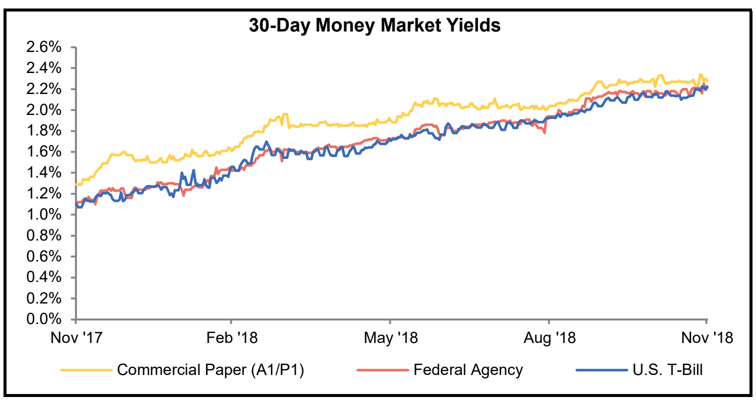
Index	Nov 30, 2017	Oct 31, 2018	Nov 30, 2018	Monthly Change
1-Month LIBOR	1.37%	2.31%	2.35%	0.04%
3-Month LIBOR	1.49%	2.56%	2.74%	0.18%
Effective Fed Funds Rate	1.07%	2.20%	2.20%	0.00%
Fed Funds Target Rate	1.25%	2.25%	2.25%	0.00%
Gold ($/oz)	$1,273	$1,215	$1,220	$5
Crude Oil ($/Barrel)	$57.40	$65.31	$50.93	-$14.38
U.S. Dollars per Euro	$1.19	$1.13	$1.13	$0.00

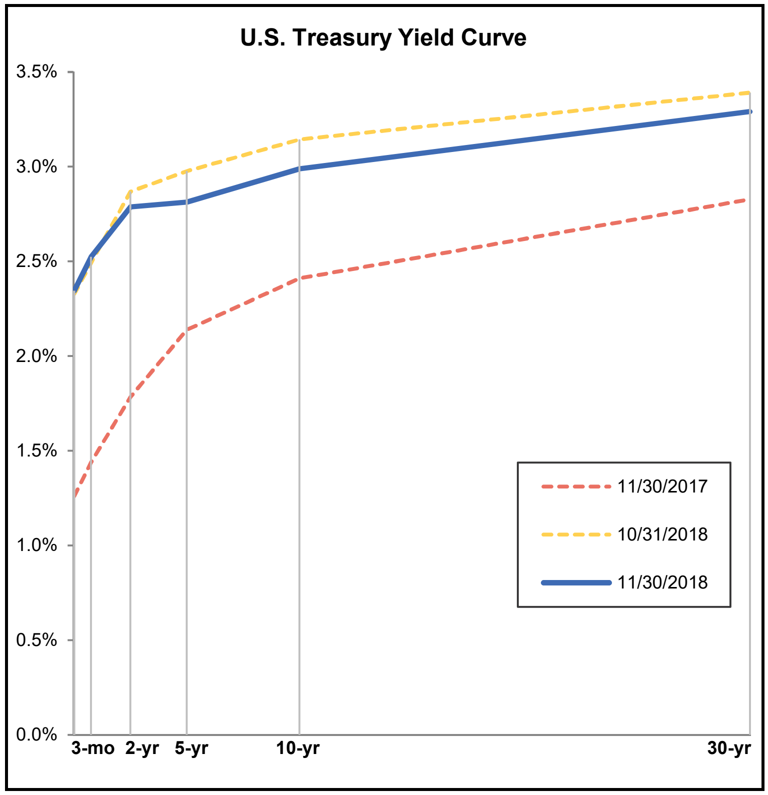
Economic Indicators

Indicator	Release Date	Period	Actual	Survey (Median)
Nonfarm Payrolls	7-Dec	Nov	155k	198k
CPI ExFood&Energy YoY	14-Nov	Oct	2.1%	2.2%
Retail Sales MoM	15-Nov	Oct	0.8%	0.5%
Consumer Confidence	27-Nov	Nov	135.7	135.7
GDP Annualized QoQ	28-Nov	3Q Sec	3.5%	3.5%
New Home Sales MoM	28-Nov	Oct	-8.9%	4.0%
FOMC Rate Dec. (Upper)	8-Nov	Nov	2.25%	2.25%









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