



Monthly Market Review

Robust tailwinds created positive momentum for the economy and the equity markets as the new year began. The strengthening economy presents a good environment for fixed income investors, but also raises the risk of higher rates that could drag down returns on longer-duration investments.

Economic Highlights

- After months of build-up and speculation, Congress passed a controversial tax cut bill in late December. This new legislation, the first major tax reform since 1986, lowers the corporate tax rate to 21% from 35%, while also lowering individual tax rates. Early assessments suggest a positive economic reaction for the near-term.
- Final tallies for second and third quarter U.S. gross domestic product (GDP) were 3.1% and 3.2%, respectively. This is the first time since 2014 that the U.S. economy grew at more than 3% in back-to-back quarters. Economists raised projections for growth over the next year to the 2.5 - 3% level with consumer spending and private investment bolstering those estimates.
- At its December meeting, the Federal Open Market Committee (FOMC) raised the overnight fed funds target rate for the third time in 2017, to a new range of 1.25% to 1.5%. Despite two dissenting votes to keep rates unchanged in December, Federal Reserve (Fed) Governors and many investors anticipate another three hikes in 2018.
- Inflation, which has the potential to be the primary deterrent to future Fed rate hikes, remains well below the Fed's target of 2%. Core personal consumption expenditures (PCE), year-over-year, have posted sub-two percent levels for consecutive months since May 2012.
- The December jobs report showed the economy added 148,000 jobs—a disappointing result. Overall, 2017 averaged 171,000 jobs added per month, a bit below the 221,000 per year for the prior three years. Other key labor market indicators were unchanged including the low unemployment rate and the trend of modest wage growth.

Bond Markets

- The U.S. Treasury yield curve continued to flatten in December. The combination of Fed rate hikes buoying the front end of the curve and tepid inflation restraining long-term Treasury rates has resulted in the least slope in the yield curve since 2007. Ten-year Treasury yields were unchanged in December at 2.41%, while two-year yields rose 10 basis points (bps) to 1.89%. Over the quarter, the 10-year yield was up 7 bps while the two-year yield rose 40 bps.
- The increase in short- and intermediate-term Treasury yields depressed returns for the month, as market price

erosion offset income for maturities of less than seven years. However, benchmark Treasury notes for 10- and 30-year constant maturities exponentially outpaced their shorter counterparts, posting one-month unannualized returns of 0.26% and 2.07%, respectively.

- Corporate bonds finished the year on a strong note, as credit spreads narrowed further, yet again reaching new post-recession lows.
- Despite the Fed's ongoing balance sheet reduction measures, federal agency mortgage-backed securities (MBS) provided positive excess returns relative to Treasuries in December.

Municipal Bond Market

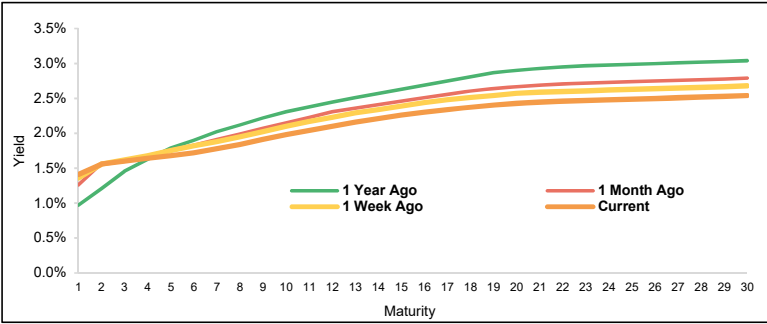
- Municipal new issuance boomed in December with a spike in municipal bond sales tripling from \$20.8 billion the same month last year to \$64.13 billion this year. Year-to-date (YTD) sales are down 2.9% to \$438.5 billion from \$451.6 billion the same period last year, according to the Municipal Market Monitor (TM3) data.
- Municipal bond flows were negative throughout the month with outflows at negative \$533 million, sliding from November's \$2.7 billion, according to Investment Company Institute (ICI) data.
- The Municipal Market Index Data (MMD) curve saw rates rising across the short-end. As of December 29, one-year rates climbed 15 bps while three-year rates were unchanged at 1.60, five-year rates fell to 8 bps, and 10-year rates slid 17 bps. On the long-end, the 30-year tightened 25 bps to 2.54%, according to TM3 data.
- The 10-year MMD Single-A General Obligation (GO) Index credit spreads and Double-A GO Index credit spreads saw changes of 48 and 18 bps respectively, according to TM3 data.
- In December, Municipal/Treasury ratios decreased across the board. The two-year ratio fell to 82.7% from 87.9% in November, and the five-year ratio slid to 76.1% from November's 82.1%. The intermediate-term ratio declined to 76.2% from 82.6% last month, and the 10-year ratio tightened to 82.3% from 89.1%. The 30-year edged lower to 92.6% from 98.6% last month, according to TM3 data.
- Municipal yield spreads continued their flattening trend with AAA two- through 10-year spreads ending December at 42 bps, tighter than last month's 58 bps. The spread between AAA two- through 30-year yields narrowed to 98 bps, flatter than last month's spread of 122 bps.

Spot Rates				
	Current 12/29/2017	1 Week Ago 12/22/2017	1 Month Ago 11/30/2017	1 Year Ago 12/29/2016
2 year	1.56	1.56	1.57	1.21
3 year	1.60	1.62	1.60	1.46
5 year	1.68	1.75	1.76	1.79
7 year	1.78	1.88	1.91	2.02
10 year	1.98	2.10	2.15	2.31
30 year	2.54	2.68	2.79	3.04

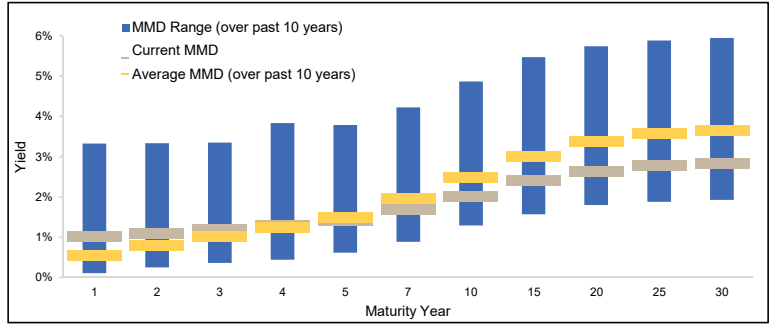
Change in Spot Rate (basis points)			
	1 Week Ago 12/22/2017	1 Month Ago 11/30/2017	1 Year Ago 12/29/2016
2 year	0	-1	35
3 Year	-2	0	14
5 Year	-7	-8	-11
7 Year	-10	-13	-24
10 Year	-12	-17	-33
30 Year	-14	-25	-50

Market Rates			
Term	MMD AAA GO	U.S. Treasury	Muni Swap Rate
2 year	1.56%	1.89%	1.49
3 year	1.60%	1.98%	1.56
5 year	1.68%	2.20%	1.70
7 year	1.78%	2.33%	1.80
10 year	1.98%	2.40%	1.90
30 year	2.54%	2.74%	2.16

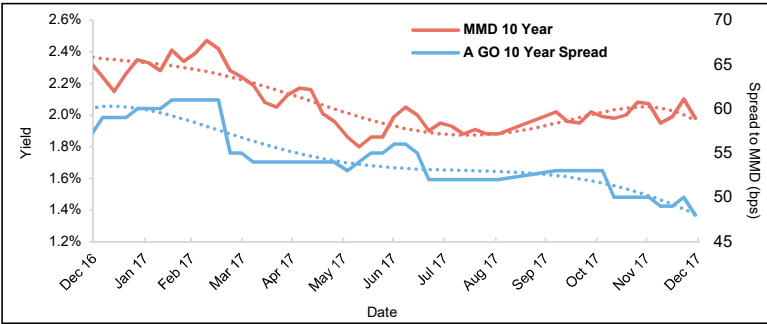
MMD AAA GO Curve



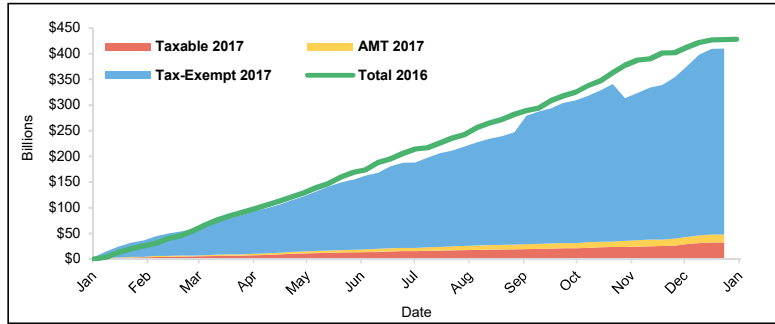
MMD Rates Over Time



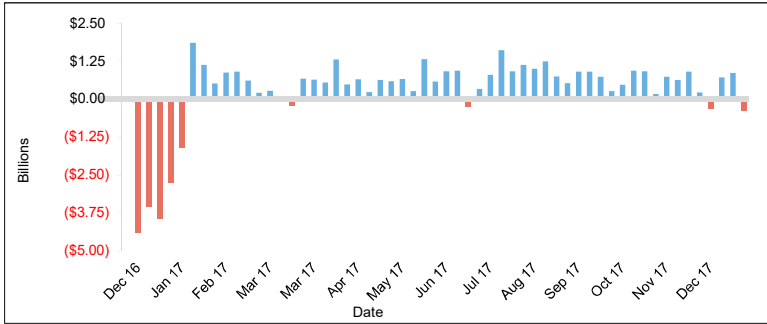
Rate and Spread Movement



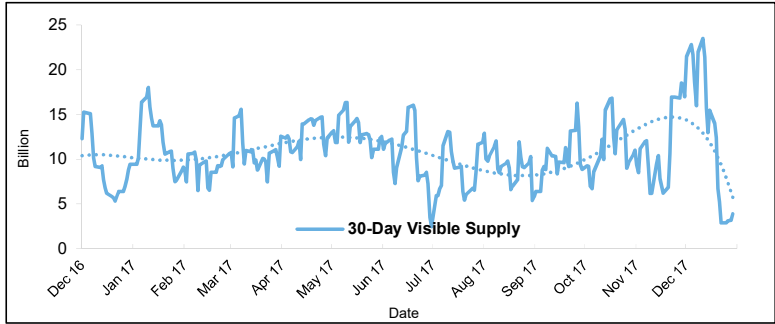
2017 Cumulative Issuance



Weekly Mutual Fund Inflows (Outflows)



30-Day Visible Municipal Supply



Economic Calendar

Date	Time	Statistic	Date	Time	Statistic	Date	Time	Statistic
01/19/18	10:00 AM	U. of Mich. Sentiment	01/25/18	8:30 AM	Advance Goods Trade Balance	01/26/18	8:30 AM	Cap Goods Orders Nondef Ex Air
01/19/18	10:00 AM	U. of Mich. Expectations	01/25/18	8:30 AM	Wholesale Inventories MoM	01/26/18	8:30 AM	Cap Goods Ship Nondef Ex Air
01/19/18	10:00 AM	U. of Mich. 1 Yr Inflation	01/25/18	8:30 AM	Initial Jobless Claims	01/29/18	8:30 AM	Personal Income
01/19/18	10:00 AM	U. of Mich. 5-10 Yr Inflation	01/25/18	8:30 AM	Continuing Claims	01/29/18	8:30 AM	PCE Core YoY
01/19/18	10:00 AM	U. of Mich. Current Conditions	01/25/18	9:45 AM	Bloomberg Consumer Comfort	01/29/18	8:30 AM	Personal Spending
01/22/18	8:30 AM	Chicago Fed Nat Activity Index	01/25/18	10:00 AM	New Home Sales	01/29/18	8:30 AM	Real Personal Spending
01/23/18	10:00 AM	Richmond Fed Manufact. Index	01/25/18	10:00 AM	New Home Sales MoM	01/29/18	8:30 AM	PCE Deflator MoM
01/24/18	7:00 AM	MBA Mortgage Applications	01/25/18	10:00 AM	Leading Index	01/29/18	8:30 AM	PCE Deflator YoY
01/24/18	9:00 AM	FHFA House Price Index MoM	01/25/18	11:00 AM	Kansas City Fed Manf. Activity	01/29/18	8:30 AM	PCE Core MoM
01/24/18	9:45 AM	Markit US Composite PMI	01/26/18	8:30 AM	Personal Consumption	01/29/18	10:30 AM	Dallas Fed Manf. Activity
01/24/18	9:45 AM	Markit US Services PMI	01/26/18	8:30 AM	GDP Annualized QoQ	01/31/18	9:45 AM	Chicago Purchasing Manager
01/24/18	9:45 AM	Markit US Manufacturing PMI	01/26/18	8:30 AM	Durable Goods Orders	01/31/18	10:00 AM	Pending Home Sales MoM
01/24/18	10:00 AM	Existing Home Sales MoM	01/26/18	8:30 AM	GDP Price Index	01/31/18	10:00 AM	Pending Home Sales NSA YoY
01/24/18	10:00 AM	Existing Home Sales	01/26/18	8:30 AM	Durables Ex Transportation	01/31/18	2:00 PM	FOMC Rate (Upper Bound)
01/25/18	8:30 AM	Retail Inventories MoM	01/26/18	8:30 AM	Core PCE QoQ	01/31/18	2:00 PM	FOMC Rate (Lower Bound)

Sources: Bloomberg, Thomson Reuters, and ICI. Unless otherwise noted, all data is presented as of December 31, 2017.

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