CHANDLER ASSET MANAGEMENT

# BOND MARKET REVIEW

A Monthly Review of Fixed Income Markets

APRIL 2017

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Since 1988, Chandler Asset Management has specialized in the management of fixed income portfolios. Chandler's mission is to provide fully customizable, client-centered portfolio management that preserves principal, manages risk and generates income in our clients' portfolios.

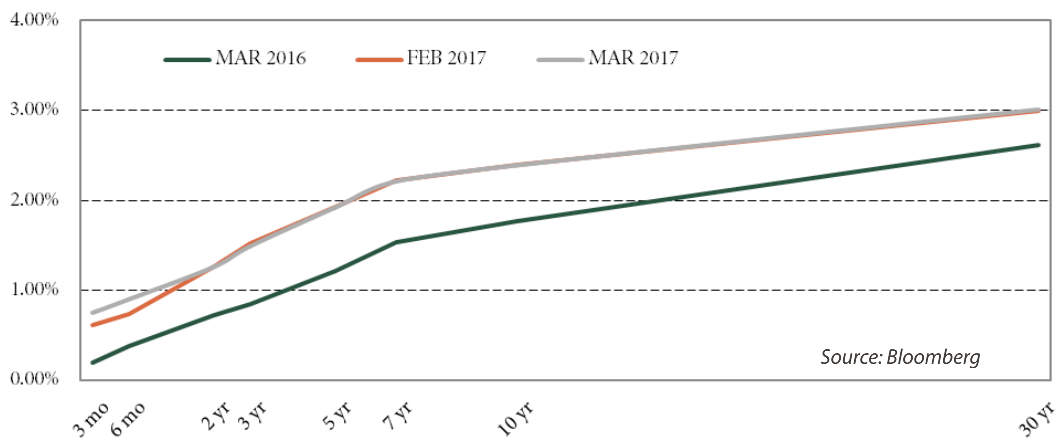
## Market Summary

The Federal Open Market Committee (FOMC) raised the fed funds target rate by 25 basis points to a range of 0.75%-1.00% in March. There was one dissenting vote from Minneapolis Fed President Neel Kashkari who preferred no rate hike. The Fed noted that economic activity has expanded at a moderate pace, labor market gains remain solid, and inflation is moving close to the Fed's 2.0% target. The Fed is still projecting a 1.4% fed funds rate by the end of this year, which implies two more 25 basis point hikes. The long-run fed funds rate projection was also unchanged at 3.0%. The FOMC did not make any decisions about their balance sheet reinvestment plans and will continue that discussion during future meetings.

Domestic economic data remains indicative of slow growth. The economy is likely at or near full employment, consumer confidence is strong, manufacturing indicators have improved, and housing trends remain favorable. Looking further ahead, a potential boost in fiscal stimulus could provide a further tailwind to economic growth. GDP grew by 2.1% in the fourth quarter. We expect GDP growth of 2.0%-2.5% in 2017.

The Treasury yield curve continued to flatten modestly in March. Very short-term Treasury yields (under 2-year maturities) increased while rates across the rest of Treasury yield curve were essentially unchanged. Meanwhile sovereign yields in Germany increased in March, and yields in Japan were little changed.

### The Treasury Yield Curve Flattened in Recent Months:




On a year-over-year basis the 2-year Treasury yield has increased 53 basis points and 10-year Treasury yield is up about 62 basis points. At the end of 2016, following the election, US Treasury yields increased meaningfully driven by heightened expectations for fiscal stimulus and growth under the Trump administration and Republican-controlled Congress. However, in recent months, the Treasury yield curve has flattened as some of the post-election exuberance regarding fiscal spending, tax reform, and healthcare reform has started to wane. The Treasury yield curve has also been influenced by movements in global sovereign bond yields as well as Federal Reserve policy tightening. The Fed has raised the fed funds rate by 25 basis points twice in the past 4 months.

| TREASURY YIELDS | Trend (▲/▼) | 3/31/2017 | 2/28/2017 | Change |
|---|---|---|---|---|
| 3-Month | ▲ | 0.75 | 0.61 | 0.14 |
| 2-Year | - | 1.26 | 1.26 | 0.00 |
| 3-Year | ▼ | 1.49 | 1.52 | (0.03) |
| 5-Year | ▼ | 1.92 | 1.93 | (0.01) |
| 7-Year | ▼ | 2.21 | 2.22 | (0.01) |
| 10-Year | - | 2.39 | 2.39 | 0.00 |
| 30-Year | ▲ | 3.01 | 3.00 | 0.01 |

*Source: Bloomberg*

## Market Data

*World Indices*
*data as of 3/31/2017*

| | Diff (2/28/17) | % Change |
|---|---|---|
| S&P 500 | | |
| **2,362.72** | (0.92) | (0.04%) |
| NASDAQ | | |
| **5,911.74** | 86.30 | 1.48% |
| DOW JONES | | |
| **20,663.22** | (149.02) | (0.72%) |
| FTSE (UK) | | |
| **7,322.92** | 59.48 | 0.82% |
| DAX (Germany) | | |
| **12,312.87** | 478.46 | 4.04% |
| Hang Seng (Hong Kong) | | |
| **24,111.59** | 370.86 | 1.56% |
| Nikkei (Japan) | | |
| **18,909.26** | (209.73) | (1.10%) |

*Source: Bloomberg*

# Economic Roundup

### Consumer Prices

The Consumer Price Index (CPI) was up 2.7% year-over-year in February, versus up 2.5% year-over-year in January. Core CPI (CPI less food and energy) was up 2.2% year-over-year in February, versus up 2.3% year-over-year in January. The Personal Consumption Expenditures (PCE) index was up 2.1% year-over-year in February, versus up 1.9% year-over-year in January. Core PCE (excluding food and energy) was up 1.8% year-over-year in February, versus up 1.7% year-over-year in January. CPI is already trending above 2.0%, and the Fed's primary inflation gauge (PCE) is approaching the Fed's 2.0% target.

### Retail Sales

On a year-over-year basis, total retail sales were up 5.7% in February compared with a 6.0% increase in January. On a month-over-month basis, retail sales were up 0.1% in February, following a 0.6% increase in January. Excluding autos and gas, retail sales increased 0.2% in February, following a 1.2% gain in January. On average, retail sales trends were solid in the first two months of the year.

### Labor Market

Nonfarm payrolls were significantly lower than expected in March, up 98,000 versus the consensus forecast of 175,000. January and February payrolls were revised down by 38,000. On a trailing 3-month and 6-month basis, payrolls increased by an average of 178,000 and 163,000 per month, respectively. The unemployment rate fell to 4.5% in March from 4.7% in February. The participation rate was unchanged at 63.0%. A broader measure of unemployment called the U-6, which includes those who are marginally attached to the labor force and employed part time for economic reasons, decreased to 8.9% in March from 9.2% in February. Wage growth rose 0.2% in March, versus expectations for a 0.3% increase. This follows an upwardly revised gain of 0.3% in February (previously 0.2%). On a year-over-year basis, wages were up 2.7% in March, vs. 2.8% in February.

### Housing Starts

Total housing starts rose 3.0% in February, following a 1.9% decrease in January. Single-family starts rose 6.5% in February, but multi-family starts declined 3.7%. On a year-over-year basis, total housing starts were up 6.2% in February.

**Credit Spreads Widened Slightly in March**

| CREDIT SPREADS | Spread to Treasuries (%) | One Month Ago (%) | Change |
|---|---|---|---|
| 3-month top rated commercial paper | 0.21 | 0.23 | (0.02) |
| 2-year A corporate note | 0.59 | 0.49 | 0.10 |
| 5-year A corporate note | 0.69 | 0.61 | 0.08 |
| 5-year Agency note | 0.10 | 0.06 | 0.04 |

*Source: Bloomberg* Data as of 3/31/2017

**Economic Data Points to Continued Slow Growth**

| ECONOMIC INDICATOR | Current Release | Prior Release | One Year Ago |
|---|---|---|---|
| Trade Balance | (43.6) $Bln FEB 17 | (48.2) $Bln JAN 17 | (45.6) $Bln FEB 16 |
| GDP | 2.1% DEC 16 | 3.5% SEP 16 | 0.9% DEC 15 |
| Unemployment Rate | 4.5% MAR 17 | 4.7% FEB 17 | 5.0% MAR 16 |
| Prime Rate | 4.00% MAR 17 | 3.75% FEB 17 | 3.5% MAR 16 |
| CRB Index | 185.88 MAR 17 | 190.62 FEB 17 | 170.52 MAR 16 |
| Oil (West Texas Int.) | $50.60 MAR 17 | $54.01 FEB 17 | $38.34 MAR 16 |
| Consumer Price Index (y/o/y) | 2.7% FEB 17 | 2.5% JAN 17 | 1.0% FEB 16 |
| Producer Price Index (y/o/y) | 3.7% FEB 17 | 3.0% JAN 17 | (2.0%) FEB 16 |
| Dollar/Euro | 1.07 MAR 17 | 1.06 FEB 17 | 1.14 MAR 16 |

*Source: Bloomberg*



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