Carty & Company, Inc.

Weekly Market Update – February 2018, Week 4

By Ryan R. Coombs – Senior Vice President, Research & Strategies

Compare Rates

US Treasuries			
Maturity	Yield	Change	1 Month Ago
3	2.38	0.11	2.27
5	2.61	0.10	2.51
7	2.78	0.14	2.64
10	2.86	0.15	2.71
30	3.15	0.20	2.95

Agencies			
Maturity	Yield	Change	1 Month Ago
3	2.28	0.08	2.20
5	2.50	0.10	2.40
7	2.88	0.19	2.69
10	3.22	0.17	3.05
25	3.29	0.22	3.07

Municipal G.O. (AAA) MMD			
Maturity	Yield	Change	1 Month Ago
1	1.35	(0.08)	1.43
5	1.97	0.20	1.77
10	2.48	0.22	2.26
15	2.82	0.19	2.63
30	3.08	0.20	2.88

Municipal G.O. (AAA) - TEY @ 38%			
Maturity	Yield	Change	1 Month Ago
1	2.17	(0.13)	2.31
5	3.17	0.32	2.85
10	4.00	0.35	3.65
15	4.55	0.31	4.24
30	4.97	0.33	4.65

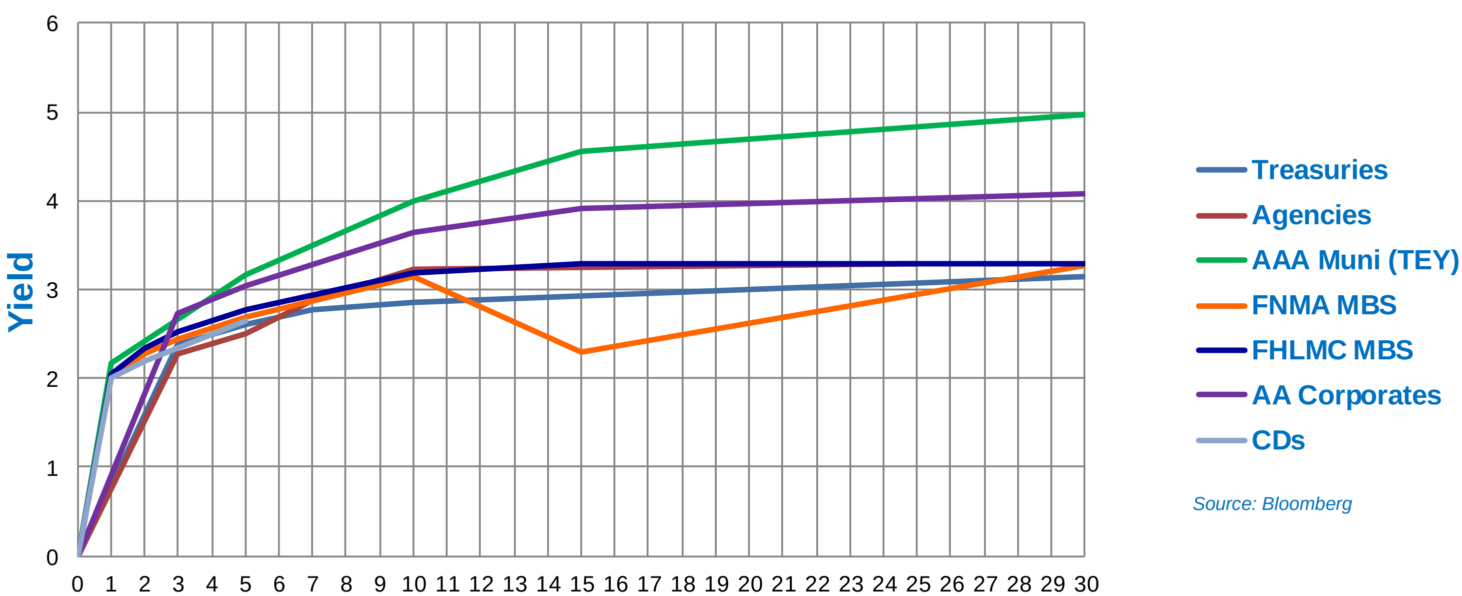
Brokered CDs			
Maturity	Yield	Change	1 Month Ago
1	2.00	0.35	1.65
2	2.20	0.35	1.85
5	2.65	0.20	2.45

Corporate Index (AA)			
Maturity	Yield	Change	1 Month Ago
3	2.74	0.23	2.51
5	3.05	0.26	2.79
10	3.65	0.32	3.33
15	3.90	0.34	3.56
30	4.08	0.33	3.75

MBS - Current Coupon			
FNMA	Yield	Change	1 Month Ago
15yr	3.04	0.33	2.71
30yr	3.51	0.34	3.17
FHLMC	Yield	Change	1 Month Ago
15yr	3.06	0.33	2.73
30yr	3.51	0.32	3.19

Equities			
Index	Current	Change	1 Month Ago
DJIA	25,087	(1464.89)	26,552
S&P 500	2,728	(140.71)	2,869
Nasdaq	7,279	(205.88)	7,485

Fixed Income Sector Performance



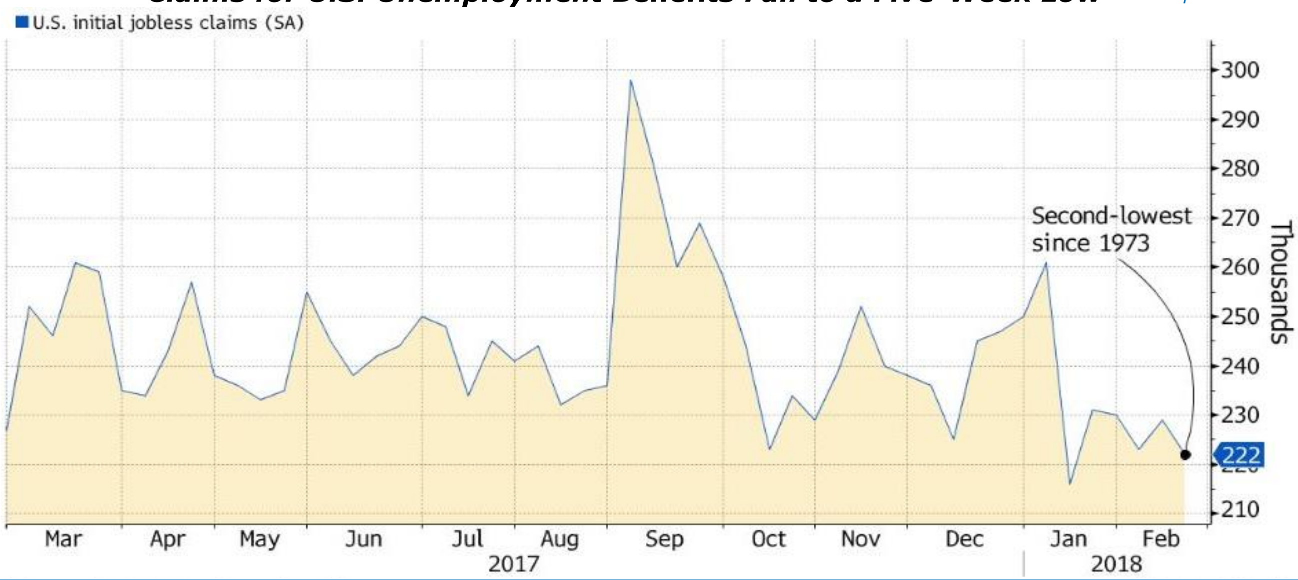
Source: Bloomberg

Claims for Jobless Benefits Fall to a Five-Week Low:

- The U.S. labor market remains on solid ground. Claims are near the lowest level in almost 45 years, a reminder that employers are holding on to existing staff given shortages of qualified workers.
  - Initial jobless claims fell by 7,000 to 220,000 last week. That equals a five-week low and less than forecast, according to Labor Department figures Thursday.
  - Applications below the 300,000 tally are considered consistent with a healthy labor market. Applications have been consistently under that key figure every week since March 2015.

Source: U.S. Labor Department

Claims for U.S. Unemployment Benefits Fall to a Five-Week Low



Fed's Quarles Says Economy in Best Shape Since Crisis:

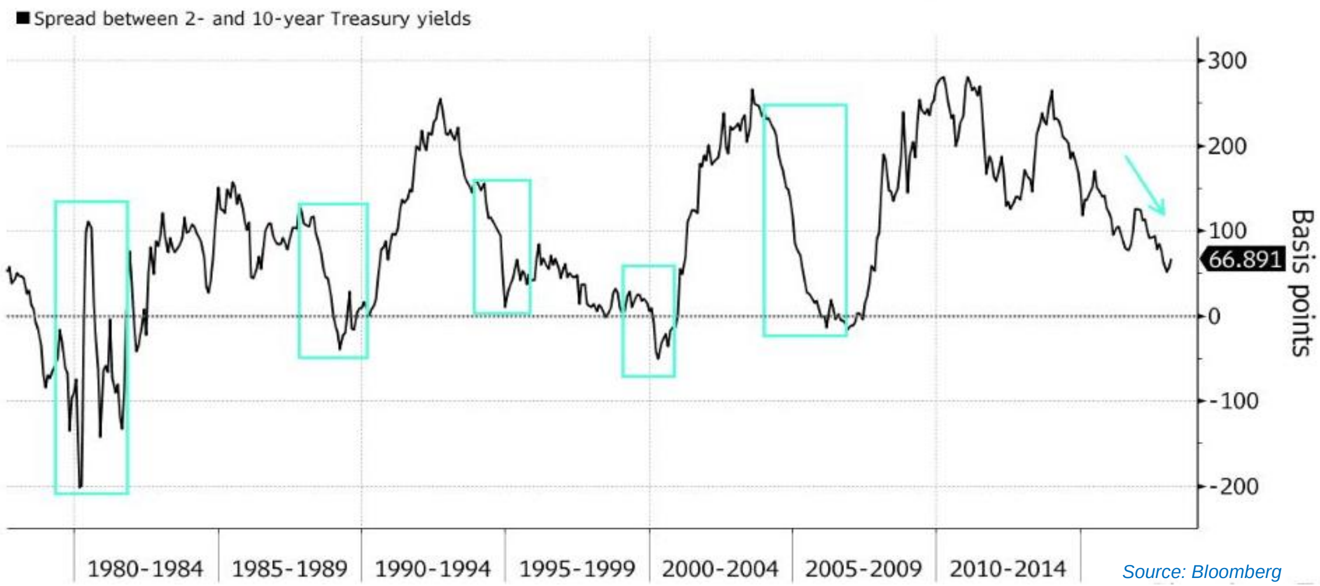
- Federal Reserve Governor Randal Quarles delivered an upbeat assessment of the U.S. economy and endorsed a "gradual" path for raising interest rates in his first public speech on monetary policy since joining the central bank in October.
  - "The U.S. economy appears to be performing very well and, certainly, is in the best shape that it has been in since the crisis and, by many metrics, since well before the crisis," Quarles said in prepared remarks Thursday in Tokyo.
  - His comments follow the release of minutes from the Fed's January 30-31 policy meeting that showed confidence growing among policy makers that growth in 2018 may exceed their December forecasts and justify additional rate hikes this year. Officials have penciled in three hikes in 2018, according to their median projection released in December.

Fixed Income

Sell-Off on 10-Year Treasuries May be Slowing:

- One of the hottest debates in financial markets right now is how high the yield on 10-year Treasuries can go. The median forecast of analysts (I am a contributing member to this survey) compiled by Bloomberg sees just a 3 percent yield on the 10-year Treasury by year's end.
  - If history is any guide, it probably will not rise much further than the 3 percent forecast. In the past five major Fed tightening cycles, longer-term Treasuries outperformed short-dated debt, flattening the yield curve as investors likely foresaw higher rates curbing inflation and keeping economic growth from overheating.

The Treasury Curve Flattened in Each of Last Five Fed Tightening Cycles



Source: Bloomberg

Municipal Yields Rise to 11-Month High:

- Municipal bonds fell for the third day Friday as yields on benchmark 10-year notes increased 0.1 basis points to 2.491 percent, the highest in more than 11 months.
  - Debt issued by U.S. states and local governments maturing in 10 years yields 85.4 percent of Treasuries, compared with 81.5 percent one month ago.
  - Trading in the municipal market totaled $13 billion last week, down 7.1 percent from $14 billion a week earlier according to the Municipal Securities Rulemaking Board.
  - Municipalities plan to sell $9.27 billion of bonds in the next month, while redemptions and announced calls total $17 billion. Nearly half the supply is from issuers in California, New York and Oklahoma.

Equities

Indexes:

- **DJIA –** 25,087 current ▼ 5.5% the past month
- **S&P 500 –** 2,728 current ▼ 4.9% the past month
- **Nasdaq –** 7,279 current ▼ 2.8% the past month

Yield Curve Effects on Equities:

- Yields have been a source of worry for stock market investors. Some analysts interpreted rising yields in late January as the spark that set off the stock-market selloff which swiftly morphed into a more-than-10% correction from the all-time S&P 500 and DJIA highs.
  - In 2017, the bond market experienced a persistent bear flattening, where short-dated yields rose faster than long-dated yields. This narrowed the yield gap between short- and longer dated Treasuries. The spread between the 2- and 10-year yields fell more than 140bps last year to 0.50%, its tightest since the financial crisis.
  - Between 1976 and 2017, bear flatteners coincided with the stock market's best years. The S&P 500 rose 19.4% in 2017, slightly above the 17.4% seen during similar periods, and well above the 12.4% notched over the last forty years.
  - So far during the first two months of 2018, investors are starting to raise expectations for inflation. Data is tentatively pointing to a pickup in wage growth and the appetite for longer-dated Treasuries undercut, lifting yields. This could be a good sign for equities as this represents a bear steepener scenario. Historically, the S&P 500 has posted a healthy annualized return of 13.7% in this environment.

S&P Average Annualized Performance during Yield Curve Shifts