



MARKET Commentary

October 2019

Macro View

Economic data continued to report uneven, but slowing economic activity both domestically and abroad. The US economy grew at an annualized pace of 1.9% in the third quarter, down slightly from 2% a quarter earlier. China, meanwhile, posted an anaemic 6% annualized growth rate for the third quarter – a level last seen in 1992. Trade war rhetoric and action is clearly impacting growth in the world’s two largest economies with ramifications spreading globally.

The British continued to wrestle with a Brexit outcome more than three years after the public referendum voted to leave the European Union. Unsurprisingly, the October 31st deadline was punted to January 31, 2020 as Parliament opted not to vote the most recent Brexit deal into law. Uncertainty abounds, but if a deal can be reached it would be viewed positively by markets after years of indecision.

The political environment will become more of a distraction as the presidential election continues to heat up. Further, the impeachment proceedings will be a source of headline risk for markets weary of Trump tweets and tirades. Trade remains a primary concern and markets are primed for completion of “phase one” of a more comprehensive trade agreement prior to December 15th when a new round of tariffs are scheduled to go into effect on Chinese goods.

Monetary Policy

The Federal Reserve (Fed) cut rates by 25 bps at their October meeting. This marks the third cut in as many meetings as officials strive to adjust policy that markets perceived as too restrictive against a weakening economic backdrop. The FOMC statement dropped “will act as appropriate” language, signaling that upcoming policy is data dependent. Policymakers will only cut further if incoming information leads to a “material reassessment” to the FOMC outlook.

The Fed commenced T-bill purchases and continued to refine its overnight and term repo programs as it reasserted control over money market rates that had been whipsawed by a combination of supply/regulatory/balance sheet factors. Fed officials will revisit repo operations more formally at the upcoming January 2020 meeting and will continue ad hoc policy measures until then.

The European Central Bank (ECB) resumed asset purchases and new leadership as former IMF head Christine Lagarde assumes the helm in November. Little change in policy direction is expected. Monetary easing is currently underway in economies that represent approximately 70% of global GDP, according to Goldman Sachs.

Federal Funds Target
1.50-1.75%

US Treasuries

As of 30-Oct

Benchmark	Yield
3 Month	1.57%
6 Month	1.61%
1 Year	1.55%
2 Year	1.60%
5 Year	1.61%
10 Year	1.77%
30 Year	2.25%

ICE BofAML Index Returns

YTD as of 30-Oct

Index	Return
0-3 Month UST	1.94%
1-3 Yr Gov/Corp ≥ A	3.60%
1-3 Yr Municipals	2.52%
1-3 Yr Agencies	3.22%
1-5 Yr Gov/Corp ≥ A	4.50%
S&P 500	23.5%

Source: US Treasury, Bloomberg, ICE/BofAML, and S&P

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Central banks are contending with slowing growth due to trade shocks while inflation trends below target and labor markets remain constrained – an unusual combination.

Markets

Over the month of October, the yield curve steepened largely due to declining front-end yields owing to the cut in fed funds. Risks asset performed well while long-duration treasury bonds lagged. Investment grade credit posted strong returns led by refining, building material and cable issuers. BBB-rated issuers outperformed their higher-rated counterparts. October supply was the lightest in four years (following a record September) providing a positive technical tailwind. High yield issuers suffered even as equity markets rallied as energy-related issuers dragged on returns.

Money market rates were much less volatile in October as the Fed exerted its influence and restored order. The Fed will be keeping a close eye on funding markets going forward and we expect the probability of a major dislocation, like that experienced in September, will be very low.

Looking Forward

Monetary policy has regained prominence globally as developed central bank policy shifted from a short pause to accommodative over the first half of 2019 broadly supporting markets. While domestic growth is slowing, an outright recession does not seem likely over the coming year. The path for future cuts will be determined by macro risks and incoming economic data. At the moment, market aren't pricing another cut until early 2021.

On the agency front, the Treasury Department and the Federal Housing Finance Agency agreed to allow Fannie Mae and Freddie Mac to retain earnings (\$25b for Fannie Mae and \$20b for Freddie Mac annually) marking the first step at moving the entities out of conservatorship. Policymakers will continue to negotiate what the appropriate level of capital should be held ahead of a possible return to private hands. Agency bond spreads have not reacted to the news as the agencies exit from conservatorship will take time and is not expected to impact outstanding debt.

The Secured Overnight Financing Rate will take another step towards replacing LIBOR as the Federal Reserve Bank of New York has proposed publishing SOFR compounded averages that will create term benchmarks at 30, 90 and 180 days as well as create an index that allows for custom time period calculation. The Fed is seeking comments currently with the expectation to publish in the first half of 2020.

Please contact the desk with questions or to discuss investment opportunities in today's market.

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