IR+M INCOME RESEARCH + MANAGEMENT

IR+M MARKET UPDATE
THIRD QUARTER REVIEW + OUTLOOK

October 16, 2018

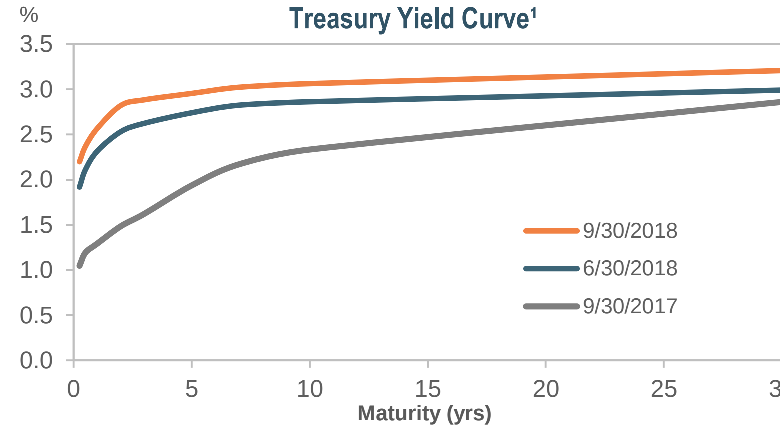
THIRD QUARTER RECAP

- The ongoing trade war with China, which sustained another round of tariffs in late September, has had little visible impact on the US economy thus far.
- In September, the Federal Reserve (Fed) raised interest rates, boosting the federal funds target range to 2-2.25% – the highest since October 2008.[1]
  - The Fed cited the continued strengthening of the labor market and solid economic activity.
- Treasury yields increased across the curve, with the 10-year yield rising 20bps to close at 3.06%, and the 5-year reaching a post-crisis peak of 2.98% before retreating to 2.95%.[1]
- Investment-grade (IG) supply exceeded $271 billion. Year-to-date, supply is down 6% from last year's record-breaking level.[3]
  - For 2018, nearly 70% of total investment-grade issuance has been derived from companies rated BBB.[3]
- In the third quarter, investment-grade corporate spreads narrowed 17bps and closed at 106bps – the tightest level since April 2018.[2]
  - High-yield spreads narrowed 47bps over the quarter, closing at 316bps.[2]
- The securitized sector generated positive excess returns relative to Treasuries, but lagged corporates.

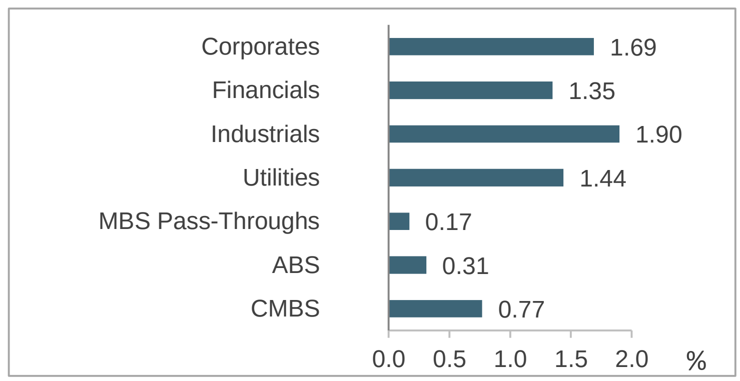
2018 GOING FORWARD

- The consensus view is that the Fed will raise rates again in December 2018, and three additional times in 2019.[1]
  - The core inflation rate continues to hover around the Fed's 2% inflation rate target.
- The potential for an inverted yield curve still exists, but that may not deter the Fed from future tightening.
- While the new Chinese tariffs have yet to significantly affect the economy, the Fed could suspend its rate hikes if trade wars remain a concern.

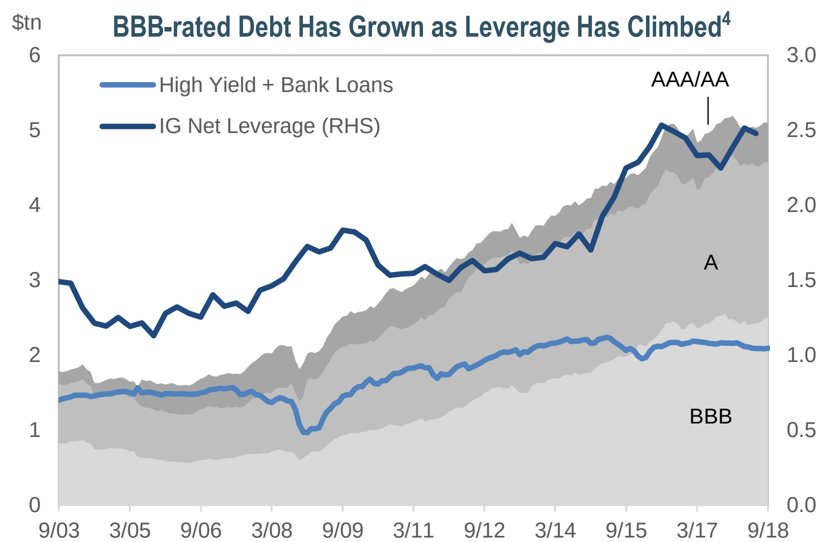
Treasury Yield Curve[1]



Third Quarter Excess Returns[2]



BBB-rated Debt Has Grown as Leverage Has Climbed[4]



Entering the fourth quarter, the US economic outlook remains strong, supported by a robust labor market that is driving consumer spending. At IR+M, we believe that it is time to lean on our years of experience, security selection skills, and conviction that a well-balanced portfolio, with prudent risk and liquidity, is the recipe for late 2018.

As of: 9/30/18. Sources: 1. Bloomberg 2. Bloomberg Barclays 3. Citigroup; 4. Bloomberg, Bloomberg Barclays, and JPMorgan as of 9/30/18. Excess returns are the curve-adjusted excess return of a given index relative to a term structure-matched position in Treasuries. The views contained in this report are those of IR+M and are based on information obtained by IR+M from sources that are believed to be reliable. This report is for informational purposes only and is not intended to provide specific advice, recommendations for, or projected returns of any particular IR+M product.