Daily Market View

Thursday, February 21, 2019

Portfolio Advisory Group – U.S. Fixed Income

Market Snapshot	7:30am CDT	Prior
30-year UST	3.03	3.00
10-year UST	2.67	2.65
5-year UST	2.49	2.47
2-year UST	2.51	2.50
6-Mo UST	2.50	2.50
3-Mo UST	2.44	2.44
10-year TIPS	0.77	0.75
10-year Corp	4.26	4.26
10-yr AAA Muni	2.15	2.15
3M LIBOR	2.40	2.64
Fed Funds	2.50	2.50
Prime Rate	5.50	5.50
CPI (YoY)	1.60	2.90
NASDAQ*	7,489	7,489
DJIA*	25,954	25,954
S&P 500*	2,785	2,785
Oil	$57.02	$56.92
Gold	$1,333.50	$1,343.30
Copper	$290.05	$292.00
Yen / US Dollar	¥110.65	¥110.85
Euro / $US	€ 1.1365	€ 1.1338

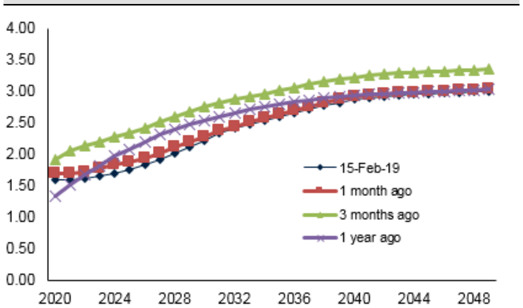
Link: Bloomberg Economic Calendar

**Previous Day*

Client Friendly Publications

Municipal Market Insight	February 2019
Global Insight Weekly	February 14, 2019
Global Insight Monthly	February 2019

Municipal AAA GO Yield Curve



Source: RBC Wealth Management, MMD

Rates

After last December's rate hike caused a sharp sell-off in risk assets, Fed officials extinguished the flames in subsequent speeches and convinced investors they were not tone deaf to the messages they were sending. From Chair Powell to Fed newcomer Mary Daly, Fed officials made it clear that rate hikes are on hold until further notice, thus markets and the media needed something new to obsess over, and the unwinding of the balance sheet is now the new focus. The $3.7 trillion in quantitative easing that swelled the Fed's balance sheet size to $4.5 trillion was an unprecedented move by a global central bank, and the shrinking process didn't come with an instruction manual either so we will likely never know the new 'optimal' size of the balance sheet…. So please stop calling it 'normal'.

Have we seen the last rate hike? The softening of global economic data in the last few months has convinced markets that the next move in the Federal Funds rate will be a cut, not a 10th rate hike. The minutes indicated that the committee will remain flexible to future developments and will adjust policy accordingly, and while market participants appear obsessed with the 'Dot Plot' projections of future policy rates, Fed officials continue to stress that future policy moves are not cemented by the 'Dot Plot' projections. In January they essentially 'tore up' Decembers economic and interest rate projections. The minutes reiterated Chair Powell's message in his January press conference by saying the Fed would be patient in deciding when and how to adjust policy in the face of a mounting set of risks, including slowing growth in China and Europe, Brexit, trade negotiations and the side effects of the 5 week government shutdown. Several committee members cited it may only be necessary to raise rates in the back half of this year only if inflation data is materially higher than the baseline outlook of 2% inflation.

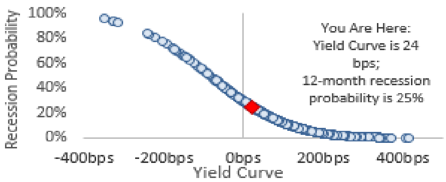
A balancing act. The balance sheet unwinding process was supposed to be like watching paint dry and the main tool for conducting monetary policy was always supposed to be changes to interest rates. For the most part the balance sheet reduction had proceeded smoothly for more than a year. Regardless the balance sheet now has taken center stage on investors radars and because market participants determine financial conditions in the economy and financial conditions matter to the Fed, the committee has to 'give investors what they want'. The minutes reiterated recent Fedspeak by saying "Almost all participants thought that it would be desirable to announce before too long a plan to stop reducing the Federal Reserve's asset holdings later this year" – so there is your answer.

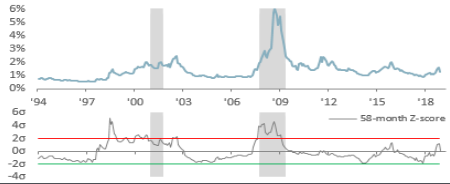
What we do know is that the balance sheet will remain much larger than before the financial crisis, and the minutes showed that a substantial majority of committee members expect the level of banking reserves left in the system will be larger than necessary and will provide for more efficient and effective implementation of monetary policy than a smaller balance sheet. We still have no clarity on a final size of the balance sheet, however the most recent NY Fed survey of primary dealers had a median estimate of $1.2 trillion in excess reserves. Fed vice Chair John Williams said he expects the level of banking reserves to end around $1 trillion, which is $600 billion less than current levels and would leave the total balance sheet at ~$3.4 trillion if he proves accurate. Most participants also favored returning to an all Treasury portfolio and continuing to let agency MBS 'roll off' and reinvest the proceeds into short-term bills. *Expect more clarity on the balance sheet in the coming weeks from a roster of Fed speakers as well as the March 20th FOMC meeting.*

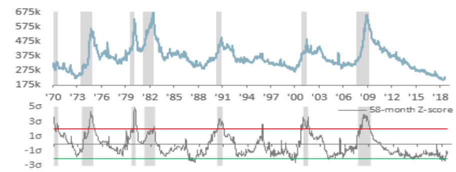
Strategy & Economics

Recession Watch Dashboard – Yield curve flashing yellow, but credit spreads & the labor market look solid

Yield Curve (10Y – 3m)			IG Corporate Credit Spreads		Weekly Jobless Claims	
Current	1w Change	Recession	Current	Current Z-Score	February 9	Current Z-Score
24 bps	+0.1 bps	25%	1.25%	+0.2σ	239k	-1.1σ







Our Thoughts: The **yield curve** curve is back in flattening mode after steepening to start the year, after reaching a YTD high of 38 bps. **Investment grade credit spreads** have tightened from the January high of 157bps along with the equity market rally, a sign that credit markets are pricing reduced recession risk; **jobless claims** remain low, but have been trending higher since Sept.

RBC Wealth Management Global Portfolio Advisory Committee: Economic Indicator Scorecard

Yield Curve			Jobless Claims			Unemp. Rate			Leading Index			PMI Orders – Inv.			Fed Funds – GDP%		
	✓		✓			✓			✓			✓			✓		

Source: RBC WM, Bloomberg; Recession probability based on NY Fed Yield Curve Model; Z-score measures significance of changes in trend over specified periods

Key U.S. Economic Data Releases

Event	Period	Survey	Actual	Prior
Philly Business Outlk.	Feb	14.0	-	17.0
Jobless Claims	Feb 16	228k	-	239k
Durable Goods Orders	Dec P	1.7%	-	0.7%
Markit Mfg PMI	Feb P	54.8	-	54.9
Leading Index	Jan	+0.1%	-	-0.1%
Existing Home Sales	Jan	5.00M	-	4.99M

Chart: Business activity surveys continue to suggest growth moderating

Source: RBC WM, Bloomberg

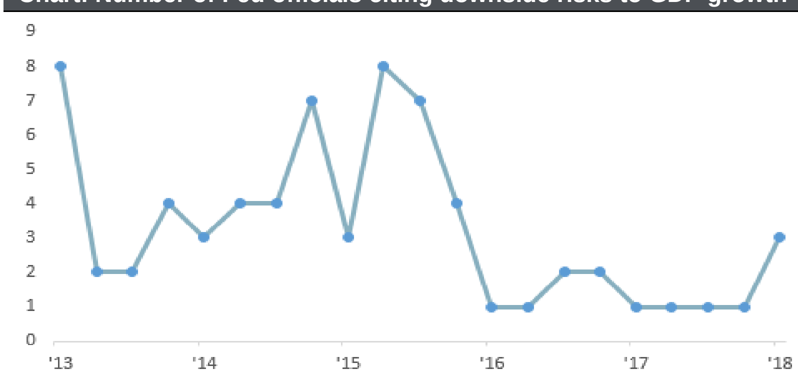
Our Thoughts

- It's a **busy day on the data front**, but nothing earth shattering is expected based on consensus.
- The focus will be on **Markit PMI** and the **Philly Fed Business Outlook**. Both index have been softening for the better part of one year now – as shown in the chart – but following the end of the gov't shutdown, markets will like to see at least some signs of life as we edge toward spring.
- **Jobless claims** remain in focus, while there were some big jumps in and around the government shutdown, the trend higher in jobless claims has been in place since last September. No signs of major stress, but we're left wondering if we've seen the bottom for this business cycle.
- Finally, homebuilder sentiment picked up on Tuesday, but we'll get an idea if the ~50bps decline in mortgage rates since last fall is helping to boost **home sales**.

Prior Session Highlights & Analysis

Event	Period	Survey	Actual	Prior
FOMC Meeting Minutes	Jan 30	-	-	-

Chart: Number of Fed officials citing downside risks to GDP growth



Source: RBC Wealth Management, Bloomberg

Our Thoughts

Fed minutes confirm dovish pivot

- There was widespread agreement for the FOMC to **end shrinkage of the $4 trillion balance sheet by the end of the year**.
- The FOMC essentially said it is **throwing out the December forecasts for two rate hikes** this year, and instead ``many'' on the committee were unsure whether any further adjustments would be needed.
- The committee is taking a patient approach in light of **increasing downside risks**, notably slowing global growth and turmoil in financial markets. Some FOMC participants were cutting their estimates for 2019 U.S. growth.
- Client-friendly PDF Link: [January 2019 FOMC Meeting Minutes]

Portfolio Advisory Group – U.S. Fixed Income Strategies