Daily Market View

Thursday, March 21, 2019

Portfolio Advisory Group – U.S. Fixed Income

Market Snapshot	7:30am CDT	1-week Prior
Federal Reserve		
Fed Funds	2.50	2.50
Inflation (1-month prior)	1.94	1.92
3m Libor	2.61	2.61
Treasuries		
3-Month	2.41	2.44
2-year	2.39	2.46
5-year	2.32	2.43
10-year	2.51	2.63
30-year	2.97	3.05
Corporates		
Investment Grade		
IG Index	**3.76**	**3.85**
AAA	3.32	3.39
AA	3.12	3.20
A	3.46	3.55
BBB	4.11	4.20
Speculative Grade		
HY Index	**6.50**	**6.55**
BB	4.87	4.95
B	6.49	6.52
Preferreds		
Hybrids	5.78	5.78
Fixed-rate	5.90	5.87
Municipals		
3-year	1.78	1.80
10-year	2.30	2.32
15-year	2.67	2.71
Long	3.20	3.27
Equities		
S&P 500	2,824	2,808
Dow Jones	25,746	25,710
NASDAQ	7,729	7,631
Commodities		
Oil	$59.89	$58.61
Gold	$1,319	$1,296

Link: Bloomberg Economic Calendar

Rates

Fireworks from the Fed: At the December 2018 meeting the Fed had expected to deliver two more rate hikes in 2019, following today's meeting that expectation officially stands at zero. They have one additional rate hike to 2.75% penciled in for 2020, but for all intents and purposes this rate hike cycle is effectively over with a Fed Funds rate of just 2.50%. As we stated following the Fed's decision at the December meeting to raise rates, it was a mistake that would likely end the rate hike cycle as the Fed missed a chance to prove its data dependency. Today the Fed is officially on hold and the next move could truly be either rate hike or a rate cut as Powell has commented recently.

GDP, Inflation & Unemployment; The key to the Fed's decision today is that they see slowing household spending and business investment weighing on near-term growth. As the first chart shows, their 2019 GDP forecast now has a range of just 1.9-2.2%, compared to a 3.1% annual rate for actual year-over-year GDP at the end of 2018. The Fed expects core inflation of just 1.8% in 2019, well-short of the 2% target, and argues for keeping rates on hold with few signs of inflationary pressures. On the employment front, they largely brushed off the slowdown in hiring in February (at just +20k) and see still-strong labor markets. But workers are still re-entering the labor force, suggesting that we are not yet at "full employment".

Yield curve flattening remains a problem; Away from economic fundamentals, the market is increasing pricing flatter yield curves — a sign that monetary policy is tightening too much, and raising the risk of recession. Following the meeting, the 10Y – 3month yield curve has dropped by 8bps to just 7bps, the lowest level of this business cycle, and according to the New York Fed's model, puts the chances of a recession within 12 months at roughly 30%. If the Fed's actions are successful today in terms of convincing markets that the Fed is on hold, we may see yield curves start to hold steady, but the only way they will materially steepen is if/when the Fed starts cutting rates.

Investment Strategy Post-Fed: Investors should start to seriously consider the possibility that yields are as good as they're going to get for some time, moving out on yield curves to lock in coupons & yields for as long as they are comfortable with. We have long used the peak in the Fed Funds rate as our speed limit for where the 10Y yield is likely to go. If the Fed delivered its last rate hike of this cycle last December with a Fed Funds rate of just 2.50%, then a 2.50% yield on the 10-year Treasury might be as good as it gets this cycle. The market is now pricing a 50% chance of a rate cut within one year, investors who stay short on yield curves are opening themselves up to the risk of soon having to reinvest at even lower rates.

Municipals

Munis rallied Wednesday, gaining 4bps on the long-end as demand for munis has continued unabated heading into tax season.

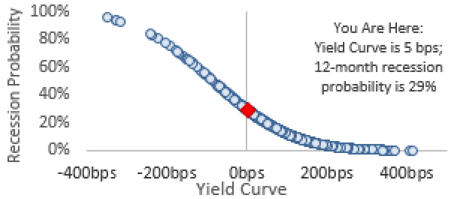
Maryland's House of Delegates passed legislation that will provide $2.2B of school construction funding, providing the state's stadium authority to issue up to $1.8B of revenue bonds backed by payments made the state's education trust-fund.

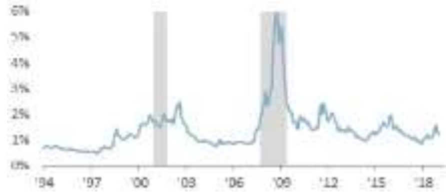
The Puerto Rico Oversight Board ramped up its battle with Governor Ricardo Rossello when it issued an eight page list of deficiencies in the governor's revised fiscal plan. The Board said it cannot certify the plan unless significant revisions are made to the plan.

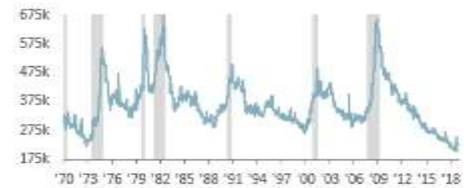
Strategy & Economics

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	YTD Change	Recession	March 9	52w High	Recession
5 bps	-10.0 bps	**29%** ●	1.20%	**-0.33%**	●	229k	**253k**	●







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** lower again following the end of the gov't shutdown

RBC Wealth Management Global Portfolio Advisory Committee: Economic Indicator Scorecard

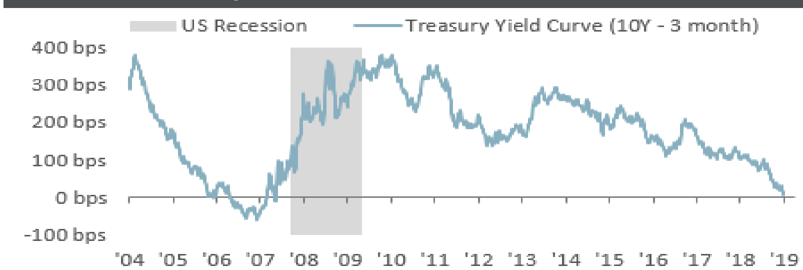
Yield Curve			Jobless Claims			Unemp. Rate			Leading Index			PMI Orders – Inv.			Fed Funds – GDP%		
	✓		✓			✓			✓			✓			✓		

Source: RBC WM, Bloomberg; Recession probability based on NY Fed Yield Curve Model;

Key U.S. Economic Data Releases

Event	Period	Survey	Actual	Prior
Philly Fed Business Outlook	Mar	4.8	13.7	4.1
Jobless Claims	Mar 16	225k	221k	229k
Leading Index	Feb	+0.1%	-	-0.1%

Chart: Benchmark yield curve nears inversion



Source: RBC Wealth Management, Bloomberg

Our Thoughts

- **Will markets now be hyper-sensitive to economic data?**
- One risk following yesterday's exceptionally dovish Fed meeting is that it's the classic case of: "what does the Fed know that we don't".
- They downgraded their growth expectations and essentially see no need for further rate hikes, and with elevated recession fears, will the market now react to any data that begins to confirm those fears?
- All eyes will be on business activity, starting with today's Philly Fed Business survey, which is strongly correlated with GDP.
- As noted above, the yield curve is now just 5bps, down 10bps from before the Fed meeting.

Prior Session Highlights & Analysis

Event	Period	Survey	Actual	Prior
FOMC Rate Decision	Mar 20	2.50%	-	2.50%

Chart: FOMC Meeting: rate forecasts shift sharply lower

Source: RBC Wealth Management, Bloomberg

Our Thoughts

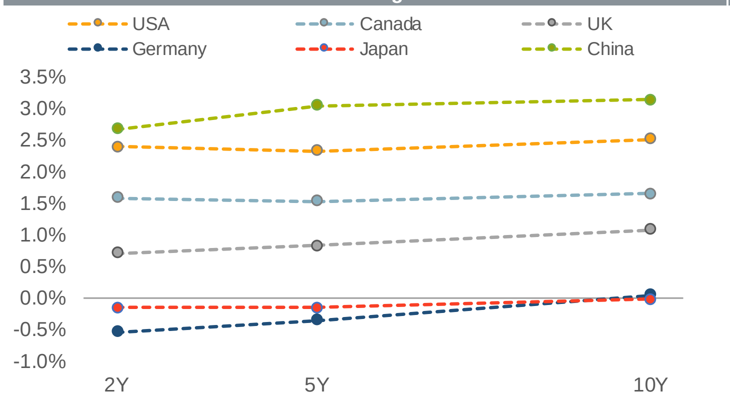
The rate hike cycle is over

- **Dipping Dots.** The median estimates of the Fed's 'Dot Plot', or rate hike expectations fell by two each year through 2021, while leaving the terminal rate—or the level of interest rates at which policy is neither boosting or restricting the economy—at 2.75%, suggesting that the current level of interest rates should support further economic expansion.
- **Wary on the outlook.** While the market volatility late last year clearly shook the Fed's confidence in pursuing 'gradual' rate hikes, the statement and projections today show that the Fed is somewhat concerned about the fundamental economic outlook as they lowered their 2019 GDP forecast to 2.1% from 2.3% in December. Inflation is also expected at 1.8%, well below the 2% target. Those two factors alone are enough to justify the Fed's pause for the balance of 2019.

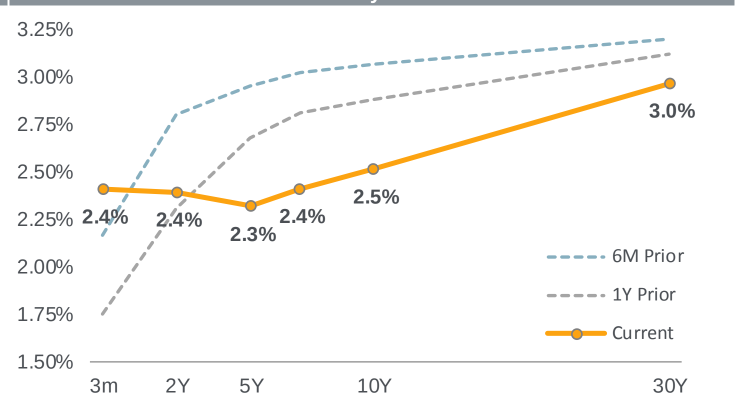
Federal Reserve & Sovereign Yields

		3M	1Y	2Y	5Y	7Y	10Y	15Y	20Y	25Y	30Y
Gov't	Treasuries	2.39	2.39	2.39	2.32	2.41	2.51	-	-	-	2.97
	Agencies	2.49	2.50	2.42	2.44	2.59	2.82	3.05	3.22	3.29	3.31
	AAA Munis	1.54	1.58	1.59	1.70	1.81	2.06	2.46	2.70	2.84	2.90
IG Corp	AA	2.55	2.60	2.61	2.77	2.98	3.25	3.61	3.88	3.96	3.97
	A	2.68	2.73	2.78	2.97	3.21	3.52	3.99	4.22	4.16	4.13
	BBB	2.96	3.02	3.14	3.48	3.81	4.16	4.63	4.90	4.86	4.80
HY Corp	BB	3.34	3.72	4.21	4.99	5.44	5.88	6.35	6.66	6.74	6.77
	B	3.90	4.32	4.88	5.90	6.45	6.89	7.41	7.82	7.76	7.75

Global Sovereign Yields



U.S. Treasury Yield Curve



Rate Forecasts	Current	2019	2020	2021
Fed's 'Dot Plot'	2.50%	▲ 3.00%	▲ 3.25%	3.25%
Market Pricing	2.50%	2.50%	▼ 2.25%	2.25%
Our View	2.50%	2.50%	2.50%	2.50%

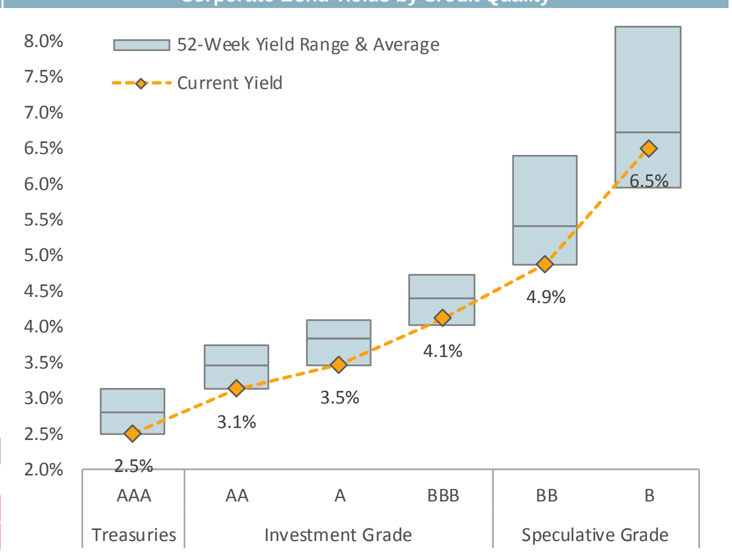
10-Year Treasury Yield Forecasts

	Q219	Q319	Q419	Q120
Consensus	2.91%	2.99%	3.03%	3.08%
RBC Capital Markets	3.15%	3.25%	3.30%	3.25%

Corporates

Sector	1w Chng	Year-to-Date Performance
Treasuries	0.52%	1.2
Investment Grade		
Index	0.70%	3.9
AA	0.56%	2.7
A	0.65%	3.5
BBB	0.76%	4.4
Speculative Grade		
Index	0.28%	6.8
BB	0.34%	6.7
B	0.31%	6.8
Preferred Shares		
Fixed-Rate	-0.28%	8.1
Hybrids	-0.20%	7.5
Equities		
S&P 500	0.58%	13.2

Corporate Bond Yields by Credit Quality

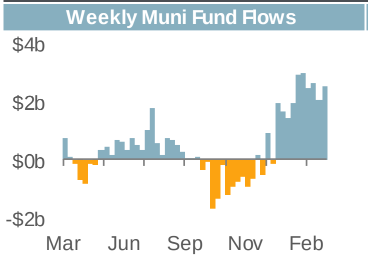


Credit Spreads over Treasuries (bps)

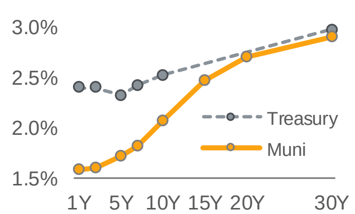
	Current	5Y Low	5Y Avg	5Y High
Investment Grade	**120**	85	126	215
Speculative Grade	**386**	303	439	839

Municipals

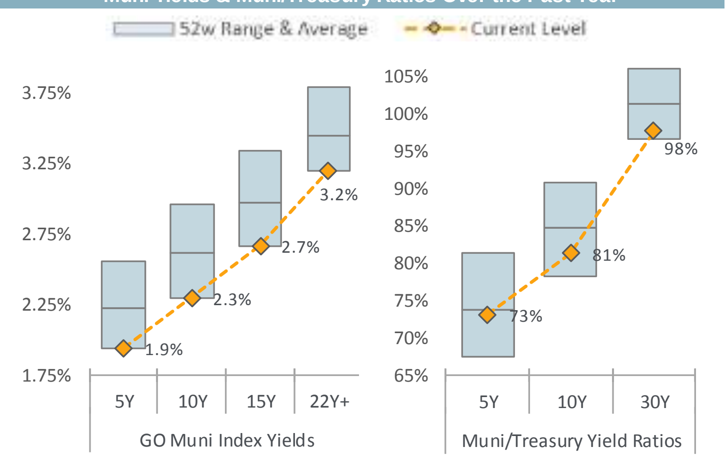
Weekly Muni Fund Flows



AAA Munis vs. Treasuries



Muni Yields & Muni/Treasury Ratios Over the Past Year



Select State Benchmark Yields

CA	2.35%	PA	2.64%	AZ	2.29%
NY	2.34%	OH	2.41%	CT	2.54%
TX	2.47%	VA	2.27%	NC	2.24%
FL	2.48%	MD	2.25%	MI	2.52%
WA	2.31%	NJ	2.93%	WI	2.34%
IL	3.09%	CO	2.65%	OR	2.32%
MA	2.35%	GA	2.39%	MN	2.31%

Source: RBC Wealth Management, Bloomberg Barclays Indexes, Federal Reserve

Portfolio Advisory Group – U.S. Fixed Income Strategies