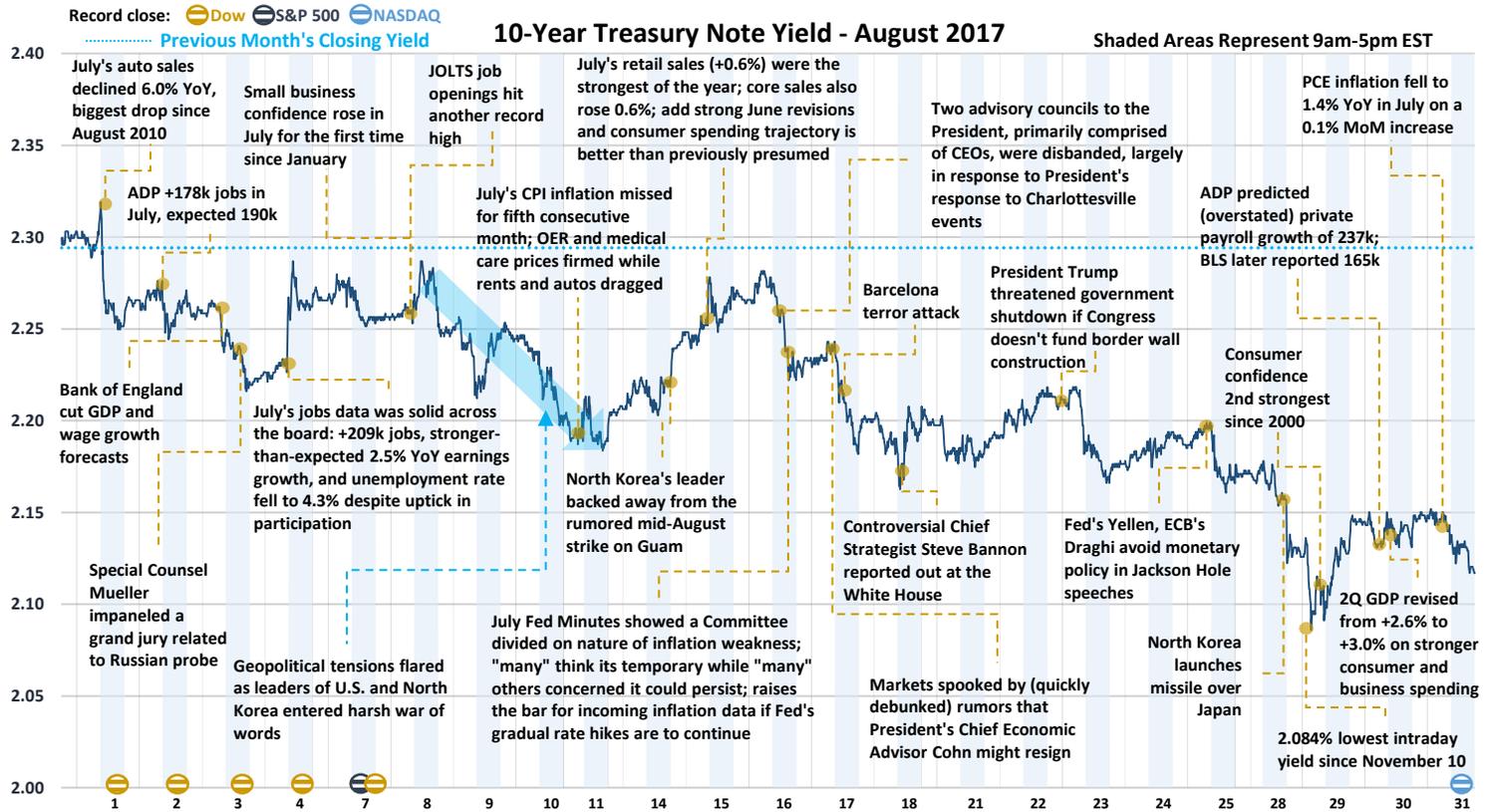


# Monthly Review

August 2017

Flight to Quality and Questions about Success of Fiscal Reforms Flatten U.S. Yield Curve in August



## Yields Fell in August on Geopolitical Concerns and Ever-Increasing Uncertainty About Republicans' Ability to Accomplish Anything on Their Pro-Growth Agenda

**Markets:** The U.S. Dollar weakened to a 31-month low in August as Treasury yields retreated on geopolitical tensions and uncertainty surrounding Republicans' efforts for pro-business reforms. Markets were spooked by an escalation of rhetoric between the U.S. and North Korea and a missile launch by the latter over Japan. Adding to the angst was the disbanding of key advisory councils to the President, changes and rumored changes in top White House staff positions, and concerns of a potential government shutdown. The yield curve finished at its flattest level between 2-year and 10-year Treasuries in a year. This all unfolded despite 2Q GDP being revised higher and consumer and business spending data firming. Importantly, inflation remained subdued and continues to be the biggest concern for the Fed. U.S. stocks managed to erase mid-month losses and finished positive for the month and front-month gasoline futures surged as Hurricane Harvey shut down refining activity in Houston.

**Consumer:** The consumer bounce back in 2Q was even stronger than the 2.8% predicted in the initial GDP release. First revisions showed consumer spending rose a stronger 3.3% from 1Q. July's retail sales report showed a continuation of the positive momentum into 3Q with a 0.6% monthly gain, the strongest of 2017. In addition, the Conference Board's confidence index climbed to its second highest level (again) since 2000. The labor market continued to tighten with hiring sufficient to meet the Fed's threshold and the unemployment rate below their longer-run forecast. However, wage growth remains a significant weak spot as it relates to the outlook for personal consumption growth and the potential for additional monetary policy tightening. Average hourly earnings grew at a subdued 2.5% YoY pace for a fifth month.

**Private Investment:** In the first revision to 2Q GDP, business fixed investment was better than initially estimated. August indications for 3Q were positive based on capital goods orders and shipments data. Inventory growth in 2Q remained weak after revision which bodes well for 3Q growth prospects; U.S. businesses have more room on their shelves to fill with 3Q production. Adding to the positivity, small business confidence rose for the first time this year. Housing investment, however, was a drag and the July data reported in August was disappointing. Housing starts and building permits, existing home sales, and new home sales all declined.

**External Trade:** Trade was accretive in 2Q but July's advanced goods trade balance showed a wider-than-expected deficit. The Dollar's monthly decline should keep the currency effect on trade as a tailwind, at least in the near-term.

**Inflation:** July's CPI inflation missed for a fifth month but owners' equivalent rent and medical care prices firmed. PCE inflation also remained subdued in July, rising 0.1% MoM which was soft enough to drop the YoY rate to 1.4%. The nature of the year-to-date weakness has become a dividing force at the Fed and a potential stumbling block for their seemingly overly-optimistic rate projections (more below).

**Monetary Policy:** The Fed's meeting in Jackson Hole offered no new revelations on monetary policy. As such, the expectation is for the Fed to announce in September when it will begin normalizing its balance sheet but the timing of the next rate increase is less clear. The July Fed Minutes showed an even split between many Fed officials who believe inflation weakness is temporary and many who fear it might persist. Fed funds futures also pushed out the greater-than-a-coin-flip's chance of the next rate hike into next summer. In Europe, the clock is ticking on the ECB's QE program with the scheduled December end quickly approaching. No one expects it to end then but the nature of the extension – at the current 60B Euro/month pace or something smaller – will give insight into if and how fast the ECB plans to back away from monetary policy accommodation. It will likely impact yields in both Europe and U.S. The Bank of England held policy unchanged but lowered its forecasts for GDP and wage growth.

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2-Year Treasury Note Yield - August 2017



5-Year Treasury Note Yield - August 2017



2-Year Treasury Note Yield - Last 12 Months



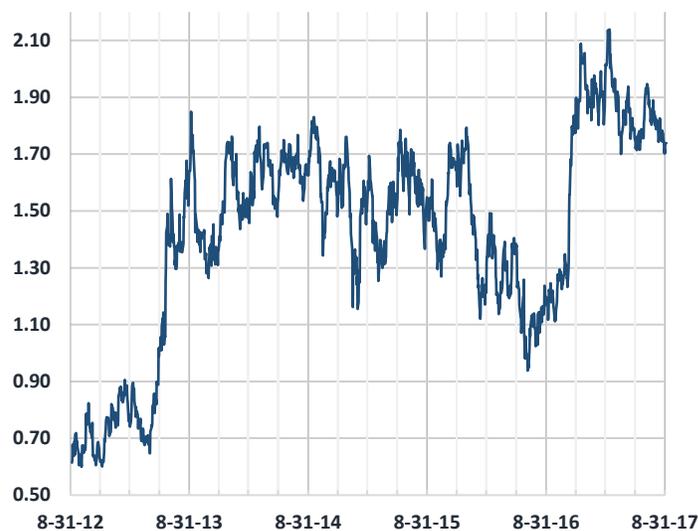
5-Year Treasury Note Yield - Last 12 Months



2-Year Treasury Note Yield - Last 5 Years



5-Year Treasury Note Yield - Last 5 Years



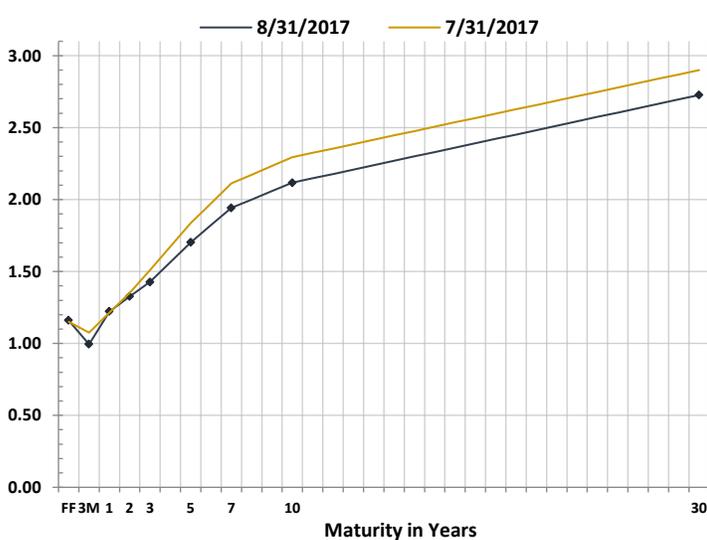
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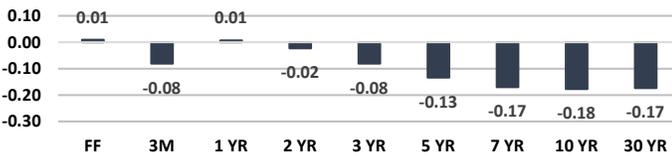
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Treasury Month-Over-Month



Month-Over-Month Change in Treasury Yields



Global Stock Performance

	Value	MTD Change	QTD Change	YTD Change
Dow Jones	21,948	0.26% ↑	2.80% ↑	11.06% ↑
S&P 500	2,472	0.05% ↑	1.99% ↑	10.40% ↑
Nasdaq	6,429	1.27% ↑	4.69% ↑	19.42% ↑
Stoxx Europe 600	374	-1.05% ↓	-1.45% ↓	3.45% ↑
China CSI 300	3,822	2.25% ↑	4.24% ↑	15.47% ↑
Nikkei 225	19,646	-1.40% ↓	-1.93% ↓	2.78% ↑

Global Sovereign Debt Performance

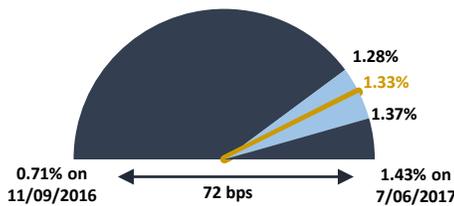
	Yield	MTD Change (in bps)	QTD Change (in bps)	YTD Change (in bps)
U.S. 2-year	1.33%	-2.4 ↓	-5.6 ↓	13.7 ↑
U.S. 5-year	1.70%	-13.4 ↓	-18.6 ↓	-22.5 ↓
U.S. 10-year	2.12%	-17.7 ↓	-18.7 ↓	-32.7 ↓
German 10-year	0.36%	-18.2 ↓	-10.5 ↓	15.3 ↑
U.K. 10-year	1.03%	-19.6 ↓	-22.3 ↓	-20.5 ↓
French 10-year	0.66%	-14.0 ↓	-15.3 ↓	-2.4 ↓
Italian 10-year	2.05%	-4.9 ↓	-11.3 ↓	23.0 ↑
Japanese 10-year	0.01%	-7.4 ↓	-7.7 ↓	-3.7 ↓

Commodity Performance

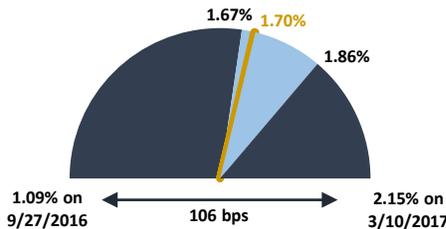
	Value	MTD Change	QTD Change	YTD Change
WTI Crude	\$ 47.23	-5.86% ↓	2.58% ↑	-12.08% ↓
U.S. Dollar	92.67	-0.21% ↓	-3.10% ↓	-9.34% ↓
Gold Spot	1,321	4.09% ↑	6.43% ↑	14.68% ↑
Commodity Index	84.66	0.31% ↑	2.49% ↑	-3.27% ↓

Treasury Notes Intraday Ranges: 52-Week Yield Range / Monthly Yield Range / Last Traded Yield

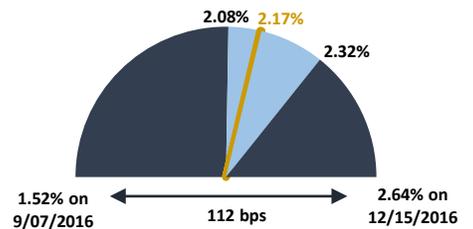
2-Year Treasury



5-Year Treasury



10-Year Treasury



Nonfarm Payrolls

July 189k

Strong across the board

Unemployment Rate

July 4.3%  
Down 0.1%

Fell (due to rounding) as strong hiring outpaced an uptick in participation

Existing Home Sales MoM

July -1.3%

After detracting from 2Q GDP, the housing sector continued to disappoint in July

New Home Sales MoM

July -9.4%

2nd biggest monthly gain of 2017

Core Retail Sales

July 0.6%

Strongest gain of 2017

Consumer Confidence

August 122.9  
Up 2.9 pts

2nd strongest since 2000

ISM Non-Manufacturing

July 53.9  
-3.5 pts

Lowest in 11 months

ISM Manufacturing

July 56.3  
-1.5 pts

Manufacturing Production

July -0.1%

Core Capital Goods Orders

July 1.0%

2nd biggest monthly gain of 2017

Trade Balance

June -43.5B  
+2.9B

Wider than expected

Core PCE YoY

July 1.4%  
Down 0.1%

Slowest since 2015

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