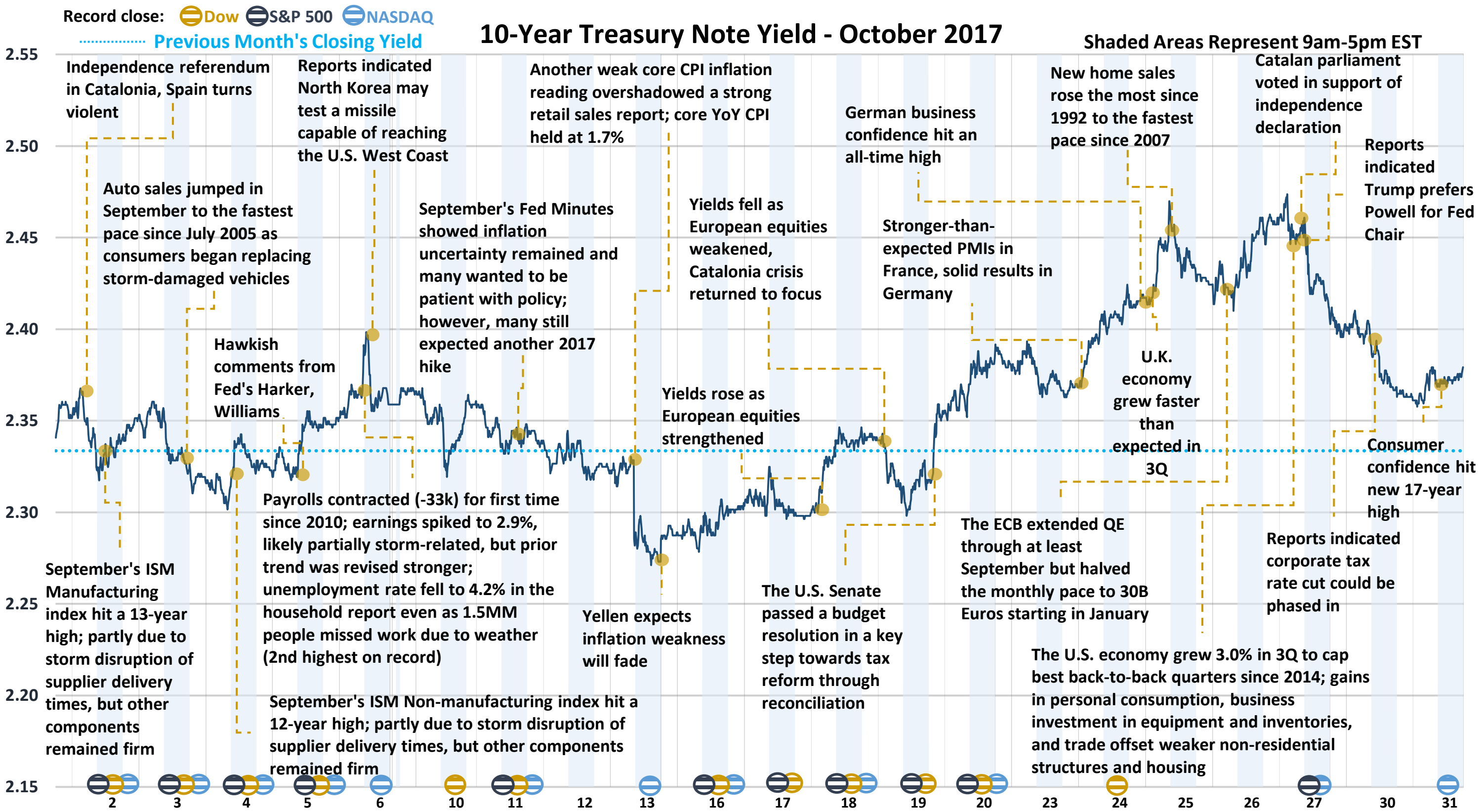
Monthly Review

VINING SPARKS

October 2017

Curve Flattening Trend Continues as Fed Eyes December Hike Despite Persistent Weakness in Inflation



Growing Expectations for a December Rate Increase Paired with Soft Inflation and Slower Central Bankers Elsewhere Leave the Curve at its Flattest Levels Since 2007

Markets: The Treasury curve continued its flattening trend in October and shorter yields continued to drive higher in anticipation of another Fed hike. Fed funds futures added 20%-points to the probability of a December hike (to ~84%) and the 2-year yield added 12 bps to 1.60%. Longer yields rose more modestly after another soft inflation report and a likely dove-for-dove swap at the top of the Fed offset the effects of a better-than-expected 3.0% 3Q U.S. GDP print, another step towards U.S. tax reform, and solid growth indicators in Europe. The 10-year added just under 5 bps to 2.38%. The Dollar rose the most since February after the Euro weakened following the ECB's latest decision. U.S. stocks rose for a seventh consecutive month as 3Q corporate earnings provided some positive surprises. The Dow's 4.3% monthly gain led the way in what was the best month for the big three indices since February. U.S. crude added 5.2% on hopes that OPEC will extend its production cuts and as U.S. stockpiles continued to contract. The commodity closed at its highest level since February.

Consumer: Consumer indicators remained strong as personal consumption in the initial 3Q GDP release topped estimates and consumer confidence surged to new cycle highs. Consumers spent 2.4% more in 3Q on an annualized basis compared with a 3.3% 2Q increase; a slower-but-still-strong pace. The Conference Board's confidence index rose to its highest level since 2000 while the University of Michigan's climbed to its best since 2004; both were better than expected. As expected, September's jobs report was distorted by the hurricanes as the initial print showed the first contraction (-33k) since 2010 and earnings spiked to 2.9%. However, there were positive revisions to prior months' earnings pace and the unemployment rate fell to its lowest level since 2000. Initial claims continued to improve supporting the story that September's skewed results would normalize in coming months.

Private Investment: Business investment in equipment rose four a fourth consecutive quarter in 3Q, the best run since 2014. Spending on structures slowed but companies added more to inventories. On net, businesses added 1.2% to 3Q GDP. Looking forward, the ISM reports were strong, partly because of hurricanes, and capital goods orders data remained upbeat. However, business confidence eased; the chance for sustained strength in business activity will likely be determined by the success or failure of tax reform. Housing subtracted from growth in 3Q and the sector's fast data - except for the continued brisk pace for price appreciation - remained choppy.

External Trade: Trade was accretive to growth for a third consecutive quarter in 3Q, the longest run since 2013. A weaker Dollar and improving global growth continue to benefit U.S. exporters.

Inflation: Core inflation remained soft in September despite another energy lift to the headline metrics. The YoY core rates (CPI 1.69%, PCE 1.33%) remained near their lowest levels in more than a year. Despite stronger economic growth and a nearly 17-year low for unemployment, inflation pressures remain subdued.

Monetary Policy: The Minutes from the Fed's September meeting showed a Fed divided on the reasons for weak inflation but tilted towards another 2017 hike. October was the first month of the Fed allowing their balance sheet to shrink but speculation that Jerome Powell will replace Yellen as Fed Chair had a more noticeable market impact. The global economic data was also solid and continued to reflect a synchronized pick-up in activity. The European Central Bank extended, but trimmed, its monthly net asset purchases through at least September in a dovishly delivered tapering decision and markets expected the Bank of England to tighten at its November meeting. However, the Bank of Japan remained firmly committed to easy policy until elusive inflation pressures perk up.

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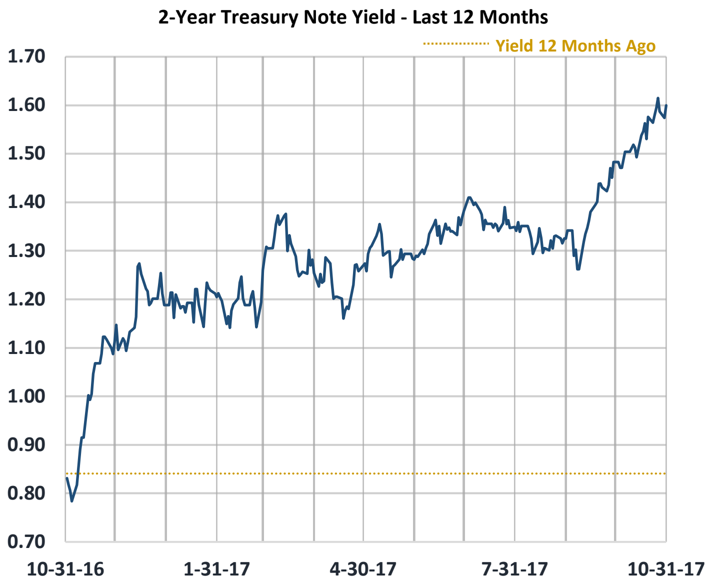

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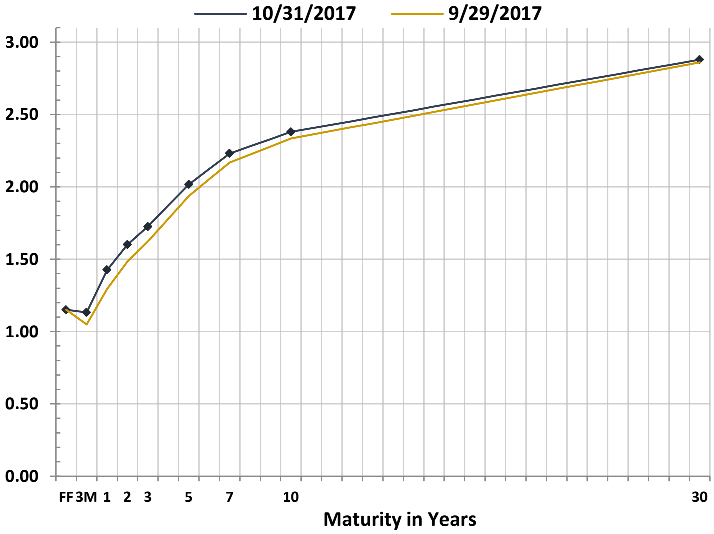
Treasury Month-Over-Month



Month-Over-Month Change in Treasury Yields

Global Stock Performance

	Value	MTD Change	QTD Change	YTD Change
Dow Jones	23,377	4.34% ↑	4.34% ↑	18.29% ↑
S&P 500	2,575	2.22% ↑	2.22% ↑	15.03% ↑
Nasdaq	6,728	3.57% ↑	3.57% ↑	24.98% ↑
Stoxx Europe 600	395	1.82% ↑	1.82% ↑	9.35% ↑
China CSI 300	4,007	4.44% ↑	4.44% ↑	21.05% ↑
Nikkei 225	22,012	8.13% ↑	8.13% ↑	15.16% ↑

Global Sovereign Debt Performance

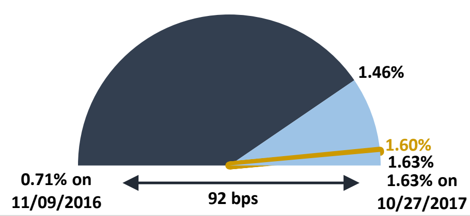
	Yield	MTD Change *(in bps)*	QTD Change *(in bps)*	YTD Change *(in bps)*
U.S. 2-year	1.60%	11.7 ↑	11.7 ↑	41.1 ↑
U.S. 5-year	2.02%	8.1 ↑	8.1 ↑	8.9 ↑
U.S. 10-year	2.38%	4.6 ↑	4.6 ↑	-6.5 ↓
German 10-year	0.36%	-10.1 ↓	-10.1 ↓	15.5 ↑
U.K. 10-year	1.33%	-3.3 ↓	-3.3 ↓	9.3 ↑
French 10-year	0.76%	1.2 ↑	1.2 ↑	6.9 ↑
Italian 10-year	1.83%	-28.4 ↓	-28.4 ↓	1.2 ↑
Japanese 10-year	0.07%	0.3 ↑	0.3 ↑	2.5 ↑

Commodity Performance

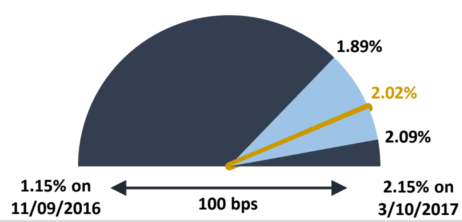
	Value	MTD Change	QTD Change	YTD Change
WTI Crude	$ 54.38	5.24% ↑	5.24% ↑	1.23% ↑
U.S. Dollar	94.55	1.59% ↑	1.59% ↑	-7.49% ↓
Gold Spot	1,271	-0.71% ↓	-0.71% ↓	10.31% ↑
Commodity Index	86.19	2.05% ↑	2.05% ↑	-1.52% ↓

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

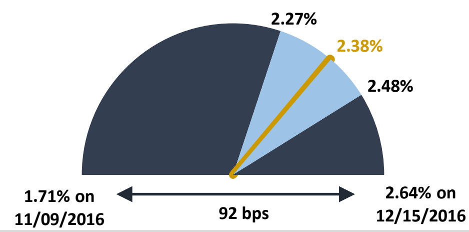
2-Year Treasury



5-Year Treasury



10-Year Treasury



Nonfarm Payrolls	Unemployment Rate	Existing Home Sales MoM	New Home Sales MoM	Core Retail Sales	Consumer Confidence
September -33k	September 4.2% Down 0.2%	September 0.8%	September 18.9%	September 0.4%	October 125.9 Up 5.3 pts
Brushed off as effect of hurricane disruption	Lowest level since 2001	Hurricanes continued to impact the data; new home sales saw biggest monthly gain since 1992 to fastest pace since 2007			Highest since 2000

ISM Non-Manufacturing	ISM Manufacturing	Manufacturing Production	Core Capital Goods Orders	Trade Balance	Core PCE YoY
September 59.8 +4.5 pts	September 60.8 +2 pts	September 0.1%	September 1.3%	August -42.8B +0.8B	September 1.3% Up 0.03%
Hurricanes impacted the ISM supplier delivery metrics; non-manuf. highest since 2005, manufacturing highest since 2004			Business equipment spending outlook remained solid		