WEEKLY TRADING DESK UPDATE

WEEK OF JUNE 11TH - 15TH

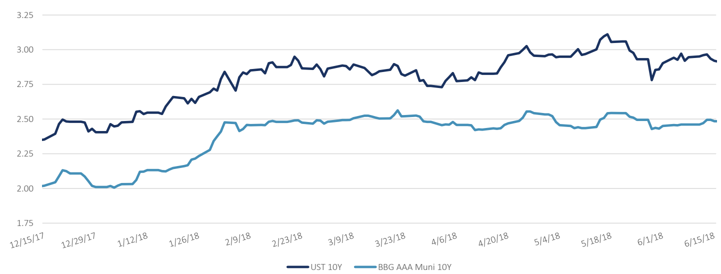
TRADING DESK COMMENTARY

- Market pundits were predicting that last week would be the most significant for fixed income investors thus far in 2018. At stake was both a likely increase by the Federal Reserve and a more definitive timeline from the ECB to end its Eurozone bond buying program. While the tone of both announcements was actually outside of what markets were anticipating, they did not point in the same direction and by the end of the week seemingly offset each other.
- Here at home the Federal Reserve followed through with an expected 25bps increase to Fed Funds, now 1.75-2.00%. More important, though, was the hawkish tone from the committee statement that was more upbeat on the US economy and within the updated set of Governors' projections that now shows 4 hikes expected this year and at least 3 in 2019. On the other side of the pond, though, things were not quite as optimistic. Despite an announcement that quantitative easing would likely end in December, it was President Draghi's forward guidance pointing to a soft inflation backdrop and the doubtfulness of rate increases until the summer of 2019 that sent European yields right back to near-term lows (10YR Bund ~ 0.40%).
- On the economic front US data has been running a little better than expected lately. Inflation releases in the form of CPI showed continued firming with core (ex-auto) prices rising 2.2% yoy. Retail sales stood out last week with May's ex-auto number coming in at 0.9% and helping push most forecasts on Q2 GDP above 4% (Atlanta Fed's GDPNow at 4.8% for Q2). Next week will be reasonably quite on the data front, but we will be keeping a close eye on further trade developments.
- Front end muni/treasury ratios remain rich, however ratios toward the longer end of the curve are near the high end of their recent range. Front end outperformance has largely been driven by investors dodging duration in the face of rising interest rates, while long end ratios have cheapened due to a continued unwinding of banks' municipal holdings post tax reform. We think the rally in the front end of the muni curve may be slightly overdone and are looking beyond the 1yr to 3yr portion of the curve to pick up additional yield while not adding substantial duration.
- Fund flows into the municipal space continue to be positive, reflecting continued demand from retail investors. Primary supply remains down; year-to-date issuance is approaching $145bn with negative net supply of ~$9bn. We remain constructive on munis over the near term simply due to a growing supply/demand imbalance. June issuance appears to be average, but July supply is looking thin: Bloomberg Municipal 30 Day Visible Supply is down to ~$8B (off 37%) from over $14bn at the beginning of the month.
- On the credit front, the fiscal 2019 budget season has been a positive one for several states. S&P, over the past week, has revised its outlook to stable from negative on Virginia, Alaska, and Colorado. In Colorado meaningful pension reform was the catalyst for the upward revision as the State expects to fully fund its pension obligations within 30 years. Alaska adopted legislation that limits draws from its Permanent Fund earnings to an amount that is sustainable yet enough to pay $1,600 dividends to Alaskans. This legislation coupled with additional spending cuts reduced the State's structural deficit by 80%. Finally, Virginia's recently passed budget provides for planned deposits back into the state's reserve fund, which had been drawn down over the past several years.

MARKET OVERVIEW

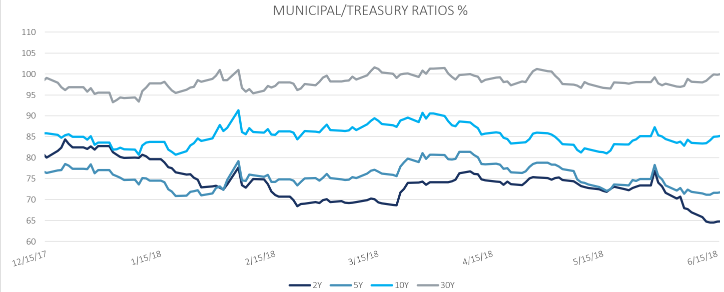
		6/11/18	6/15/18	Δ bps	1M Trend
Muni	2Y	1.66	1.65	-1	
	5Y	2.00	2.00	0	
	10Y	2.46	2.49	2	
	30Y	3.03	3.04	1	
UST	2Y	2.52	2.54	2	
	5Y	2.80	2.79	-1	
	10Y	2.95	2.92	-3	
	30Y	3.09	3.04	-5	

10Y UST vs AAA MUNI

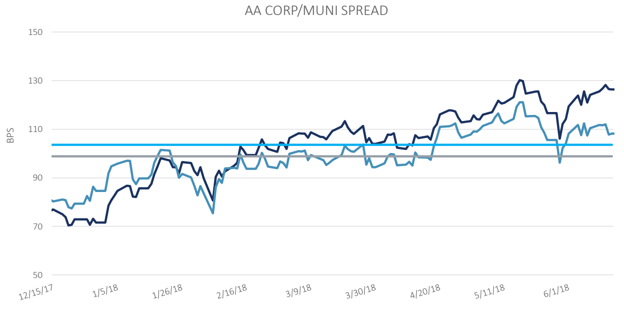


		5/15/18	6/15/18	1M Trend
MUNI/UST Ratios	2Y	73%	65%	
	5Y	74%	72%	
	10Y	83%	86%	
	30Y	98%	100%	

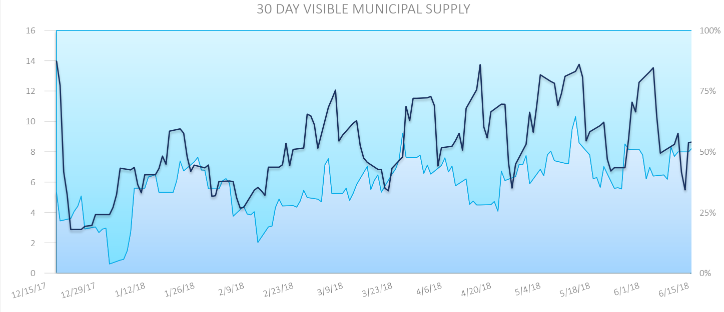
MUNICIPAL/TREASURY RATIOS %



AA CORP/MUNI SPREAD



30 DAY VISIBLE MUNICIPAL SUPPLY



Please refer to the second page for sources, definitions and disclosure information.

EXPLANATION

30 Day Visible Supply: The total dollar volume of municipal securities expected to be offered over the next 30 days. The visible supply, which is compiled and published by The Bond Buyer, indicates the near-term activity in the municipal market. Competitive and Negotiated are broken out as a percentage of total supply.

Bloomberg PICK Offerings: The total dollar amount of offerings listed on Bloomberg's dealer offerings system. The figure helps gauge secondary supply in the market.

Bond Buyer 20 G.O. Index: Index published weekly representing the average yield of 20 G.O. bonds with 20 year maturities, rated AA2 by Moody's.

SOURCES: 30 day visible figures are obtained through Bloomberg, and produced by The Bond Buyer. The 20 G.O. index yield is obtained through Bloomberg, and produced by The Bond Buyer. Pick offerings par value, UST supply, economic releases, and UST rates are obtained through Bloomberg Professional Service. Information obtained from these sources is believed to be reliable but is not guaranteed.