Capital Markets Group

Weekly Review—January 31, 2019

Lots to discuss as January comes to a close….

On Wednesday, Fed officials reconfirmed that the U.S. economy and monetary policy are both in a "good place" and that the central bank will probably keep interest rates steady throughout the year. After the central bank held its benchmark rate steady, Fed Chair Powell stated in the post-FOMC press conference that "monetary policy is well positioned to serve the American people by supporting continued economic growth." While he did express concerns that the "coronavirus outbreak will likely impact Chinese output in the near term, there are some signs that global growth may be stabilizing"- i.e. reduced trade tensions. Although the Fed left overnight rates unchanged, they did make clear that the Committee was not comfortable with inflation running consistently below target. The Fed's preferred inflation gauge – year-over-year core PCE – increased slightly in December to 1.58% from November's 1.53% - consistent with its 5-year average of 1.59% but below the Fed's 2% target. Since Fed Chairman Bernanke established its 2% inflation target in 2012, inflation has been below their target 90% of the time.

Yesterday, the first look of 4QTR19 GDP showed that the U.S. economy expanded at 2.1%, unchanged from its previous announcement and consistent with 3rd quarter growth. While growth remained consistent in the last half of 2019, consumer spending continues to trend lower. Specifically, personal consumption increased only 1.8% in the final quarter of last year, down from 3QTR19's 3.2% and 2QTR's 4.6%. This pull-back by consumers will weigh on future economic growth as consumer spending accounts for nearly 70% of U.S. economic growth.

As for the bond market, yield curve inversion returned as the spread between short-term yields and 10-year Treasuries went negative for the first time since last October. Evidenced in the below graph, the upward bias in rates at the end of the Fed's December FOMC meeting has been replaced with the market's expectation for lower rates. Although curve inversion is normally due to slowing growth and inflation concerns, the bond market looks to be sending the message that the Fed needs to lower interest rates as investors are concerned about policy makers' ability to counter any headwinds as the deadly coronavirus threatens to disrupt global growth.

Obviously, the uncertainties associated with the potential impact of the coronavirus combined with the continued global investor demand for treasuries (due to negative rates abroad) have driven investors to seek the safety of the U.S. bond market. While the virus scare will hopefully settle down in the near term, I would expect this treasury "flight to safety" trend to remain intact for the bulk of 2020. Add to that a Fed that is pretty much on the sidelines, I believe the risk remains to the downside. Meaning, there are more reasons for rates to continue downward than to increase materially from current levels. Based on the curve's current inversion, market participants are thinking that the Fed should throw a lifeline to the markets by dropping rates sooner than later. The Fed funds future market currently shows a 67% probability that the fed will cut rates <u>at least</u> 25bps by July. The probability increases to 89% by Feb 2021. It'll be interesting to see exactly how long the Fed stays out of the game…

Your comments/questions are encouraged.

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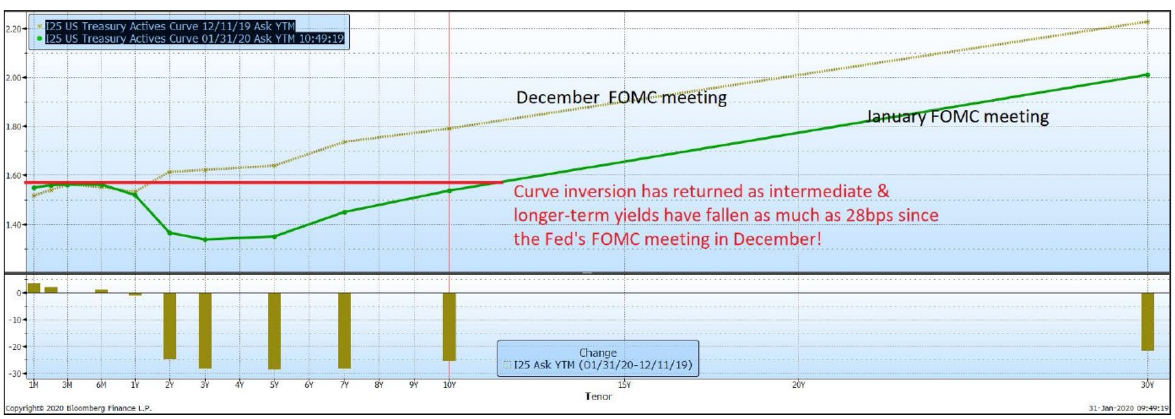

NEW ISSUE MUNICIPAL CALENDAR			
Date	Amount ($)	Description	Maturity
02/03/2020	$1,505,000	Sterling KS UT GO BQ NR	2021-2040
02/03/2020	$7,825,000	Peculiar MO UT GO BQ A	2021-2035
02/04/2020	$2,920,000	Baldwin City KS TMP NTS UT GO BQ SP1+	2021

ECONOMIC CALENDAR				
Monday 2/3	Tuesday 2/4	Wednesday 2/5	Thursday 2/6	Friday 2/7
Markit US Manufacturing PMI	Factory Orders	MBA Mortgage Applications	Initial Jobless Claims	Change in Nonfarm Payrolls
Construction Spending MoM	Durable Goods Orders	ADP Employment Change		Unemployment Rate
ISM Manufacturing		Trade Balance		Wholesale Inventories MoM

KEY INDICES

	Current	Last Month	One Year Ago
Prime Rate	4.75	4.75	5.50
Discount Rate	2.25	2.25	3.00
Fed Funds Rate	1.55	1.55	2.40
IOER	1.60	1.55	2.40
1-Month Libor	1.66	1.78	2.51
11th Dist COFI	1.04	1.10	1.06
1-Yr. CMT	1.45	1.57	2.57
Dow	28,256.03	28,538.44	24,999.67
NASDAQ	9,150.94	8,972.60	7,281.74
S&P 500	3,225.52	3,230.78	2,704.10
Bond Buyer	2.47	2.74	4.22

MUNI AA—BQ

3 Mo.	0.80
6 Mo.	0.83
1-Year	0.85
2-Year	0.89
3-Year	0.90
5-Year	0.93
7-Year	1.06
10-Year	1.30
30-Year	2.00

Treasuries & New Issue Agencies *(Spread to Treasuries)*

	Treasuries	Bullets	NC-6 Mo.	NC-1 Year	NC- 2 Year
3 Mo. Bill	1.54				
6 Mo. Bill	1.53				
1-Year Bill	1.45				
2-Year Note	1.35	4	18	7	
3-Year Note	1.32	4	32	20	
5-Year Note	1.33	7	50	40	22
7-Year Note	1.43	16	54	44	29
10-Year Note	1.52	25	70	59	48
30-Year Bond	1.99				

CMO Spreads to Treasuries

	PAC	Vanilla
1-Year	N/A	+42
2-Year	45	56
3-Year	56	66
5-Year	68	77

MBS Current Coupon Yields

GNMA 30 Yr.	2.30%
FNMA 30 Yr.	2.38%
GNMA 15 Yr.	1.85%
FNMA 15 Yr.	2.00%

About the Author, Dennis Zimmerman

In 2015, Dennis joined Commerce Bank's Capital Markets Group as Manager of Asset/Liability Services. With his leadership, the Capital Market's ALM team provides asset/liability management consulting services to community banks.

Prior to joining Commerce, he was employed for nearly 26 years at one of the largest privately-held banks in Kansas. In addition to managing a $775 million bond portfolio, his Asset/Liability Chairman responsibilities included managing margin, interest rate risk, liquidity and capital. Prior to becoming the bank's Finance Treasury Officer, he was a Registered Investment Representative and Supervising Principal in the bank's Capital Markets division.

As a seasoned professional, Mr. Zimmerman offers a comprehensive understanding of bank finance treasury, fixed income, complex financial analysis as well as regulatory and operational awareness. As a banker, he understands the challenge of balancing shareholder expectations within appropriate levels of risk.

The Weekly Review is a publication of the Capital Markets Group of Commerce Bank.