# THE AUSTIN ADVISOR

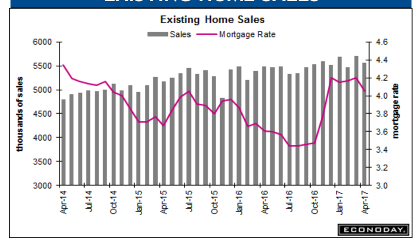
June 19, 2017

| Markets | 12-Jun | 13-Jun | 14-Jun | 15-Jun | 16-Jun | YTD% | 30-Dec-16 |
|---|---|---|---|---|---|---|---|
| DJIA | 21,235.67 | 21,328.47 | 21,374.56 | 21,359.90 | 21,384.28 | 8.21% | 19,762.60 |
| S&P 500 | 2,429.39 | 2,440.35 | 2,437.92 | 2,432.46 | 2,433.15 | 8.68% | 2,238.83 |
| NASDAQ | 6,175.47 | 6,220.37 | 6,194.89 | 6,165.50 | 6,151.76 | 14.28% | 5,383.12 |
| SNL Bank Index | 541.97 | 544.13 | 544.04 | 540.66 | 538.79 | 1.15% | 532.65 |
| Fed Funds Rate | 0.91% | 0.91% | 0.91% | 1.16% | N/A | | 0.55% |
| 1 Month LIBOR | 1.14% | 1.16% | 1.17% | 1.21% | 1.21% | | 0.77% |
| 3 Month LIBOR | 1.24% | 1.25% | 1.25% | 1.27% | 1.27% | | 1.00% |
| 3 Month T-Bill | 0.98% | 1.00% | 1.01% | 1.02% | 1.03% | | 0.51% |
| 1 Year Treasury | 1.19% | 1.22% | 1.20% | 1.21% | 1.21% | | 0.85% |
| 2 Year Treasury | 1.35% | 1.38% | 1.35% | 1.35% | 1.32% | | 1.20% |
| 3 Year Treasury | 1.50% | 1.51% | 1.48% | 1.49% | 1.48% | | 1.47% |
| 5 Year Treasury | 1.78% | 1.79% | 1.74% | 1.76% | 1.75% | | 1.93% |
| 10 Year Treasury | 2.21% | 2.21% | 2.15% | 2.16% | 2.16% | | 2.45% |
| 30 Year Treasury | 2.86% | 2.87% | 2.79% | 2.78% | 2.78% | | 3.06% |

## WEEKLY HIGHLIGHT

Short-term rates continue to move up while intermediate and long-term rates have moved lower

## EXISTING HOME SALES




(click to enlarge)

| Economy | Week of June 12, 2017 | |
|---|---|---|
| Producer Price Index | 0.0% | The overall number shows no upward pressure, but the core rate was up 0.3% |
| Consumer Price Index | -0.1% | While the Fed believes the no inflation environment is transitory, the data suggests the transition is extended |
| Retail Sales | -0.3% | Consumer spending is not growing in spite of a strong jobs market and high confidence levels |
| FOMC Meeting Ends | | The Fed did raise managed rates by another 25 basis points; the third increase in the past six months |
| Industrial Production | 0.0% | The April increase was revised upward from a very strong 1.0% growth to 1.1%, but May did not maintain any momentum |
| Capacity Utilization | 76.6% | Following the very strong rebound in April, the operating rate remained unchanged in May |
| Housing Starts | 1.092 Million | Well below expectations and down from 1.156M reported for April, providing another weak economic data point |

## ON THIS DAY IN HISTORY

1778 - Washington's troops leave Valley Forge

1846 - First officially recognized baseball game played

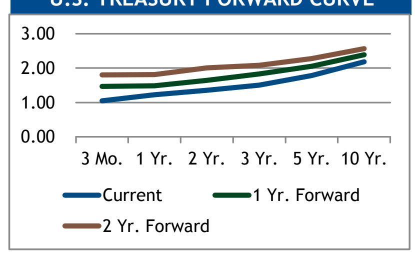
1910 - Father's Day celebrated for first time

1963 - Two Russian space missions return to Earth

1988 - World's largest sausage completed at 13.13 miles long

| Calendar | Release | Covering | Week of June 19, 2017 |
|---|---|---|---|
| Existing Home Sales | Wednesday | May | Sales are expected to be little changed from the April level as the housing data continues to disappoint |
| Leading Indicators | Thursday | June | This indicator of future economic growth has been signaling a much stronger economy than the data suggests, expect 0.3% |
| New Home Sales | Friday | May | The normal spring surge in housing has not materialized and only 590,000 is expected for May, below the 3 month average |

## U.S. TREASURY FORWARD CURVE



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## Commentary

**The Fed** followed through with its third increase in managed rates in the past six months. This was no surprise since they had sent no signal they would not continue the process of **normalizing monetary policy**. What was a surprise was the tone of the language in the statement and at the Chairman's press conference. The Fed was more hawkish than anyone expected. They did not lower their forecast for future economic growth by any meaningful amount. They did change the language in their statement, but the changes made were to indicate they were going to continue to move rates higher in a constant but gradual manner. Finally, they moved the timing of beginning the process of shrinking their balance sheet to earlier than had been thought. The Fed sees something the bond market does not. The Fed believes the weak economic data of the first half of the year is transitory and both growth and **inflation** will be much higher in the second half of the year than the first.

The weak data continued last week with a poor **retail sales report** for May, weak **housing data** and weak **industrial output reports**. The Fed cited the low **unemployment rate** and believes a tight labor market will begin to put upward pressure on inflation. The inflation data reported last week for May does not indicate this upward pressure has begun. The bond market does not believe inflation will move above the Fed's target of 2% anytime this year. **The curve** continued to flatten with the yield on the ten-year treasury dropping below 2.20%, while the yield on the two-year remains up from year end levels. In the last month, the yield on the ten-year has dropped by 10 bp while the yield on the two-year has increased by 5 bp. The yield on the ten-year has dropped from 2.60% to 2.15%, while the two-year has risen from 1.19% to 1.32% since year-end. **Consumer final demand** has not risen this year as expected, while jobs grow and confidence is near record highs.

This rate environment is beginning to put pressure on loan rates. We are hearing of more loan quotes of 4% for five-year fixed rate loans after those quotes had risen to 4.5% two months ago. A flat yield curve is never good for bank net interest income growth. Banks still have not increased rates for existing non-maturity accounts, but more are offering higher rates on shorter term CD's. The funding costs in the national market have risen as short-term rates have increased. The one-year, fixed rate advance at the FHLB is 1.45%. Many banks are offering one-year CD's at 1.15% to 1.25% in response to the increases executed by the Fed. It may make more sense to fund with a five-year advance at just over 2% than trying to grow balances in retail deposits at 1.25%. This offering rate does cannibalize existing balances and raises the cost of funding a balance sheet faster than incremental funding at the higher rate. The proper balance sheet strategy is dependent on the loan growth opportunities in each market.

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