THE AUSTIN ADVISOR

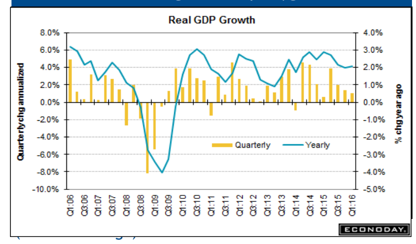
July 25, 2016

Markets	18-Jul	19-Jul	20-Jul	21-Jul	22-Jul	YTD%	31-Dec-15
DJIA	18,533.05	18,559.01	18,595.03	18,517.23	18,570.85	6.58%	17,425.03
S&P 500	2,166.89	2,163.78	2,173.02	2,165.17	2,175.03	6.41%	2,043.94
NASDAQ	5,055.78	5,036.37	5,089.93	5,073.90	5,100.16	1.85%	5,007.41
SNL Bank Index	400.47	400.65	401.21	398.52	401.06	-7.05%	431.48
Fed Funds Rate	0.40%	0.40%	0.40%	0.40%	0.40%		0.35%
1 Month LIBOR	0.49%	0.49%	0.49%	0.49%	0.49%		0.43%
3 Month LIBOR	0.70%	0.70%	0.70%	0.71%	0.72%		0.61%
3 Month T-Bill	0.32%	0.31%	0.32%	0.32%	0.33%		0.16%
1 Year Treasury	0.52%	0.56%	0.56%	0.54%	0.55%		0.65%
2 Year Treasury	0.68%	0.70%	0.73%	0.70%	0.71%		1.06%
3 Year Treasury	0.85%	0.84%	0.86%	0.82%	0.84%		1.31%
5 Year Treasury	1.14%	1.12%	1.15%	1.11%	1.13%		1.76%
10 Year Treasury	1.59%	1.56%	1.59%	1.57%	1.57%		2.27%
30 Year Treasury	2.30%	2.27%	2.30%	2.29%	2.29%		3.01%

WEEKLY HIGHLIGHT

The political turmoil in the U.S. poses a risk to continued low rates

REAL GDP-ADVANCE



Economy	Week of July 18, 2016	
Housing Starts	1.189 Million	
Existing Home Sales	5.570 Million	Sales increased rather than the small decline expected, with the highest reading since the Great Recession
Leading Indicators	+0.3%	The index reflects a moderate pace of economic activity in the next six months

Calendar	Release	Covering	Week of July 25, 2016
Consumer Confidence	Tuesday	July	The Conference Board's measure jumped to 98.0 in June from less than 95, and is forecast to drop down to 96.4
Durable Goods Orders	Wednesday	June	Orders have been very volatile, with business investment weak; expect a drop of 1.3% following the 2.2% decline in May
FOMC Meeting Ends	Wednesday		No change in monetary policy expected, but stronger data cited in the anouncement should be included
Real GDP-Advance	Friday	2nd Qtr	The consensus calls for a +2.6% number, with revisions taking the final number above 3%

MONDAY MUSING

The LPGA held a tournament in Toledo two weeks ago. I got a phone call from a friend of mine on Monday before the tournament. His mother-in-law had died on Sunday and the funeral was on Wednesday. The problem was he had paid for a place in the pro-am on Wednesday and he was in a foursome with Jim Harbaugh, the coach of the University of Michigan football team. He asked me if I could substitute for him. Of course, I said yes. He said great, the service was at the church on Main Street and her name was Betty.

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Commentary

The **FOMC** meets this week, with no change in managed rates expected. **The Fed** lowered its economic forecast at the June meeting and lengthened its guidance for future monetary policy changes. Investors will be looking for language in the announcement following the meeting to be more positive than the past three meetings. This time we expect the Fed to cite the fact that **inflation** remains below their target of 2% as the reason to be cautious in their effort to normalize managed interest rates.

The Advance report for second quarter **Real GDP** will be released on Friday with a consensus of a +2.6% gain, as compared to 1.1% in the first quarter and 1.4% in the fourth quarter. This strength is being driven by a strong rebound in **consumption**. Given the stronger data from June, which will be estimated in the Advance report, we expect the final growth for the quarter will be above the number released this week. The inflation data from this report is expected to be well above the prior two quarters. Even this strong data is not expected to cause the Fed to move **managed rates**. The Fed is going to make sure the better environment is sustainable. A strong third quarter is going to be required to get the Fed to continue to move managed rates higher.

Market interest rates have recovered some of the declines experienced after the **Brexit** vote, but remain well below year end levels. Investors are not pricing any inflation risk in current market rates. Europe and Asia continue to pump liquidity into their markets in an effort to stimulate faster economic growth. It is difficult to get market rates higher in the U.S. when rates are as low as they are in foreign markets. Capital continues to flow into our debt market seeking safety and higher yields. This condition should continue until the Fed signals they are going to move managed rates up again. The very competitive loan rate environment means earning asset yields will be under pressure in the coming year. Loans being booked with rates below 4% will cause total portfolio loan yields to drop. Additionally, **pre-payments** from the existing loan portfolio will cause further downward pressure on **earning asset yields**. The ability to offset this pressure with lower funding costs is no longer available. The second half of the year will be difficult for banks unless they can increase their **loan-to-asset ratio** to generate a **positive mix variance**. A stronger economy should produce better loan growth opportunities, but the lower yields generated will hold revenue gains down.

Trusted Advisor to Financial Institutions
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