



The**ECONOMY**

Growth and the Punchbowl: How Much is too Much?

Within the investment community, there is an adage that central bankers will “take away the punch bowl” when the party is heating up. At present, consumers remain bullish, corporations are investing, and economic indicators are largely exceeding economist expectations; in other words, the party is heating up. As investors, we are watching the Fed to see just how quickly the punch will be removed.

The question ultimately comes down to the number of rate increases we expect to see this year. Our view is that three-to-four quarter point increases are likely in 2018 and consensus is starting to move in that direction.

This conservative view is based on inflation readings and inflation precursors that fairly consistently surpass expectations. Construction spending, consumer sentiment, manufacturing activity, and inventories are all growing. While this strength is good in the short-term, a robust economy tends to presage inflation in the longer term. February’s CPI reading showed that inflation is picking up at an unexpectedly high rate. Fed rate increases are all but certain to follow.

Investable assets reflect these expectations. Equities have corrected from the late January highs with benign valuations based on earnings, and very rich valuations when considering the total value of firms. The difference is due to the use of debt in this low-rate environment. Because of the low rates, bond spreads are nearing the tightest level (high price) of the current business cycle.

Returning to the punchbowl analogy, economic participants have had a few cups, and the Fed is taking note. We are now focused on how aggressively and how often the Fed will act.

Treasury Yields

MATURITY	3/7/18	2/7/18	CHANGE
3 Month	1.649%	1.542%	0.107%
6 Month	1.870%	1.721%	0.150%
1 Year	2.038%	1.889%	0.149%
2 Year	2.252%	2.124%	0.128%
3 Year	2.416%	2.321%	0.095%
5 Year	2.649%	2.557%	0.092%
10 Year	2.883%	2.836%	0.047%
30 Year	3.150%	3.114%	0.036%

Source: Bloomberg

Agency Yields

MATURITY	3/7/18	2/7/18	CHANGE
3 Month	1.675%	1.525%	0.150%
6 Month	1.799%	1.615%	0.184%
1 Year	1.956%	1.791%	0.165%
2 Year	2.323%	2.193%	0.130%
3 Year	2.482%	2.363%	0.119%
5 Year	2.735%	2.627%	0.108%

Source: Bloomberg

Commercial Paper Yields (A-1/P-1)

MATURITY	3/7/18	2/7/18	CHANGE
1 Month	1.730%	1.590%	0.140%
3 Month	2.000%	1.780%	0.220%
6 Month	2.210%	1.970%	0.240%
9 Month	2.350%	2.130%	0.220%

Source: Bloomberg

Current Economic Releases

DATA	PERIOD	VALUE
GDP QoQ	Q4 '17	2.50%
US Unemployment	Jan '18	4.10%
ISM Manufacturing	Feb '18	60.8
PPI YoY	Jan '18	3.00%
CPI YoY	Jan '18	2.10%
Fed Funds Target	Mar 08 '18	1.25% - 1.50%

Source: Bloomberg