Economic Summary

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The Federal Open Market Committee (FOMC) has taken a more dovish stance at the March meeting following its December meeting where it raised the federal funds rate to a range of 2.25%-2.50% and implied that it intended to continue to raise rates multiple times in 2019. The Fed now implied it is on hold through year-end with rate hikes and it will also end the asset reduction program later this year. The Fed plans to halve the monthly cap on Treasury roll-offs to $15 billion in May and maintain a long-term asset base of approximately $3.5 trillion by the end of September, reinvesting up to $20 billion of Agency MBS redemptions into Treasuries each month thereafter.

Employment rebounded in March with the addition of 196,000 jobs. The number of jobs added dipped in February to 33,000 from 312,000 in January; though the government shut-down may have affected the reports. Employment has averaged 180,000 per month for the first quarter. The unemployment rate was 3.8% and the participation rate was 63.0%; the participation rate was little changed over the past 12 months. The unexpectedly strong March job rate alleviated some of the fear of an imminent US recession.

Several of the concerns for slow economic growth have been eliminated or reduced. The Fed signaled they would be on hold for the rest of the year. The Government shut-down is over. The Mueller report was finished, and it appears that impeaching the President will be difficult. The markets have concluded that there will be a China trade treaty. Some of the major drivers of the economy have slowed. Auto production will likely not add to growth this year. Housing is experiencing some relief from the recent drop in interest rates.

There are policy issues that could derail the economy. The Fed could reverse course and raise rates too quickly. Although the markets are assuming a trade deal with China, it is possible that negotiations break down over the implementation. President Trump is trying to level the playing field with our global partners, this can lead to uncertainty and trade disruption. He has just announced he is considering tariffs on Europe because of its airline industry subsidizing. He has also threatened Mexico with tariffs if they do not stop the immigrant and drug flows to the US within one year.

There is a risk that China cannot halt its growth deceleration, despite various stimulus measures. We have more confidence that the US will continue growing than confidence that Europe will recover strongly. If Japan does not postpone the Value Added Tax increase scheduled for October, it may face a slowing economy or even recession. We expect the US economy to grow at a slower pace in 2019, than 2018. Our projection for growth is 2.40% and we expect core inflation to remain around 2%.

Bill Finley, CFA
Portfolio Manager

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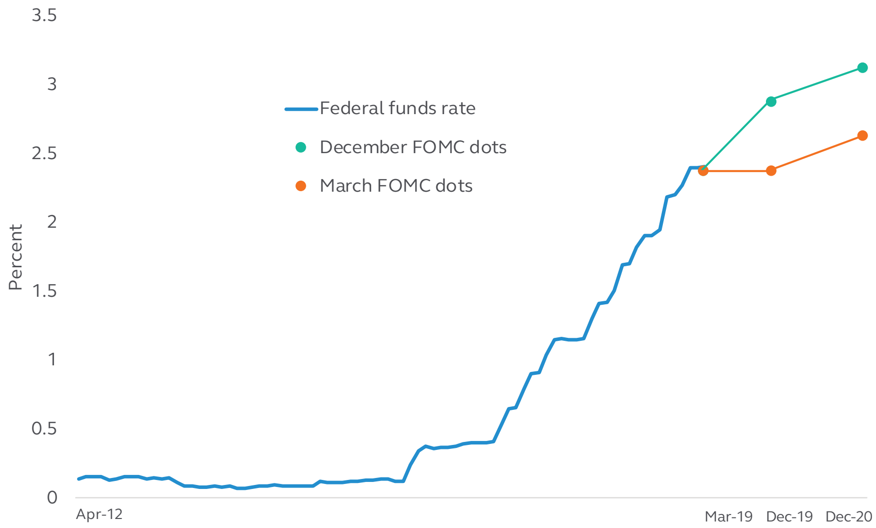
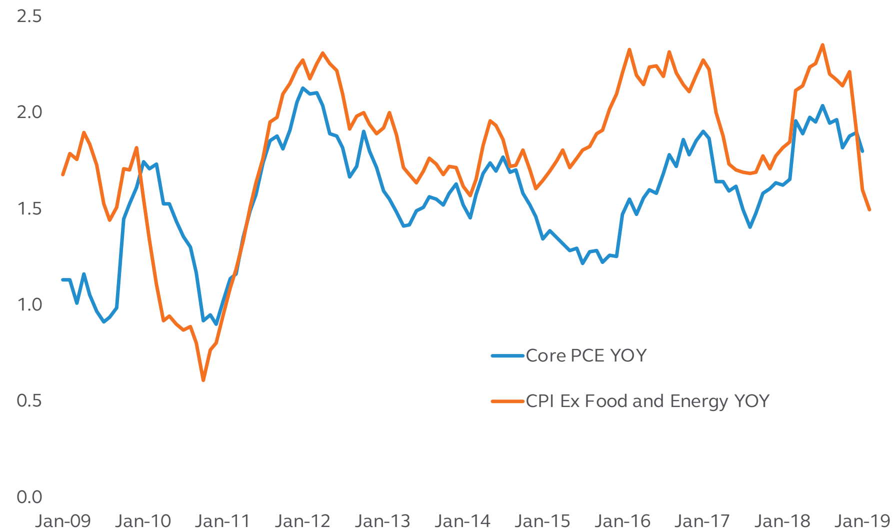
FOMC Expectations



Source: Bloomberg

Inflation



Source: Federal Reserve Bank of St. Louis

Highlights

After raising the federal funds rate to a range of 2.25%-2.50%, at the December 2018 meeting, the FOMC median expectation was for two additional rate hikes in 2019 and one in 2020.

The FOMC was more dovish at the March 2019 meeting. The federal funds rate was left unchanged from December and the median expectation for only one rate hike sometime during 2020. The market now expects that the Fed will continue to pause and is projecting a 55% probability of a cut in rates by the end of 2019.

Outlook

It is our expectation that without significant disruption in the market, the FOMC and market expectations will meet in the middle and will hold rates at current levels through 2020.

Highlights

Core Personal Consumption Expenditures (PCE) has fallen short of the FOMC's 2% target since the middle of last year, keeping it among the factors that encourages the Fed to be patient with respect to future monetary policy.

Expectation of slower global economic growth kept market-based inflation expectations range-bound during the first quarter of 2019. Break-even rates on 10-yr TIPS increased by a modest 20 bps during the quarter.

Outlook

We would expect core inflation to maintain its current level perhaps varying above or below that level dependent on growth. Market-based inflation expectation measures, for example, 10-yr TIPS break-even rates maintaining a fairly tight band around the 2% level, also reflect benign headline inflation expectations and correlation with energy prices.

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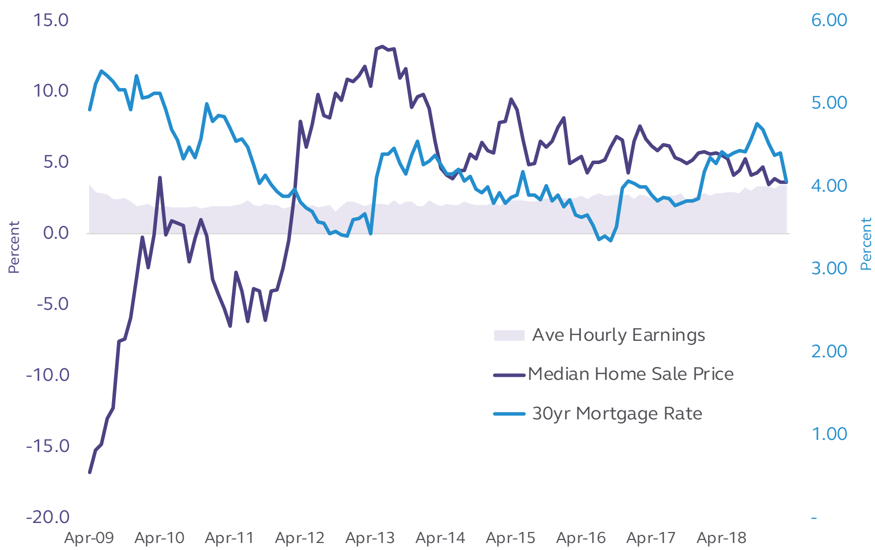
Housing and Wages



Source: National Association of Realtors, Mortgage Bankers Association, Bureau of Labor Statistics

Workforce Demographics

Source: Bureau of Labor Statistics

Highlights

After seeing double digit gains fueled by lax mortgage underwriting standards in the years leading up to the financial crisis, the US housing market experienced steep price declines culminating in a 16.8% year-over-year drop in the median home sales price in April 2009.

Historically low mortgage rates prompted by the Fed's quantitative easing policies led to a post-crisis acceleration in home price appreciation (HPA) that peaked at 13% in 2013. While top credit tier borrowers and investors benefited most from the recovery, tight mortgage underwriting standards limited participation by lower tier/first time buyers as HPA averaging 6% outpaced average wage growth of around 2%.

Outlook

More recently, HPA has moderated to around 3.5% while average hourly earnings are growing at around the same pace. In addition, 30-year mortgage rates have retraced down towards the 10-year average of 4.25% just as the spring selling season gets underway. The confluence of these factors, if sustained, should support stronger contributions to GDP from residential investment in the year ahead.

Highlights

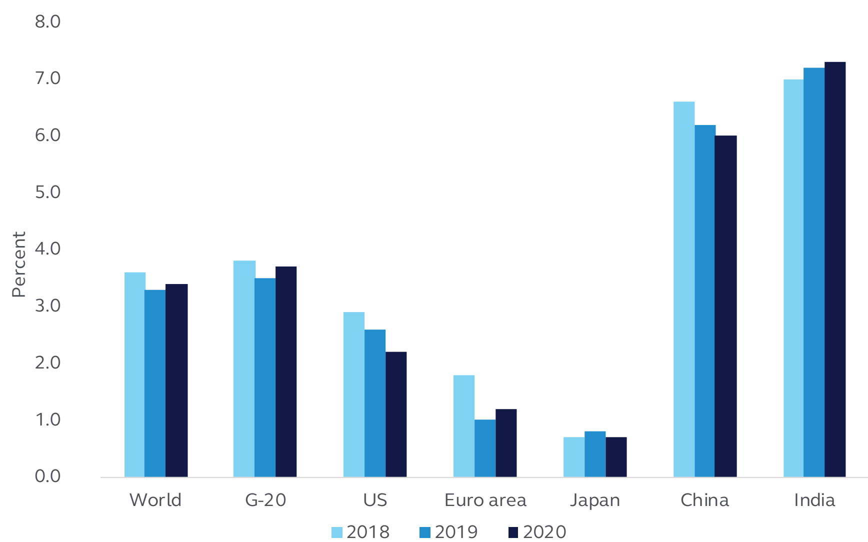
The proportion of the population of individuals considered prime working age (25yr – 54yr) peaked in 1997, coinciding with the baby boomer generation completely entering that age range, and has been decelerating since.

Employment to population growth was on a similar trajectory to demographics, showing a peak in the early 2000's before dropping sharply after two major recessions. However, after the Great Recession, a divergence has begun to occur as demographics have changed with more women and individuals outside of the 25-54yr range added to the workforce.

Outlook

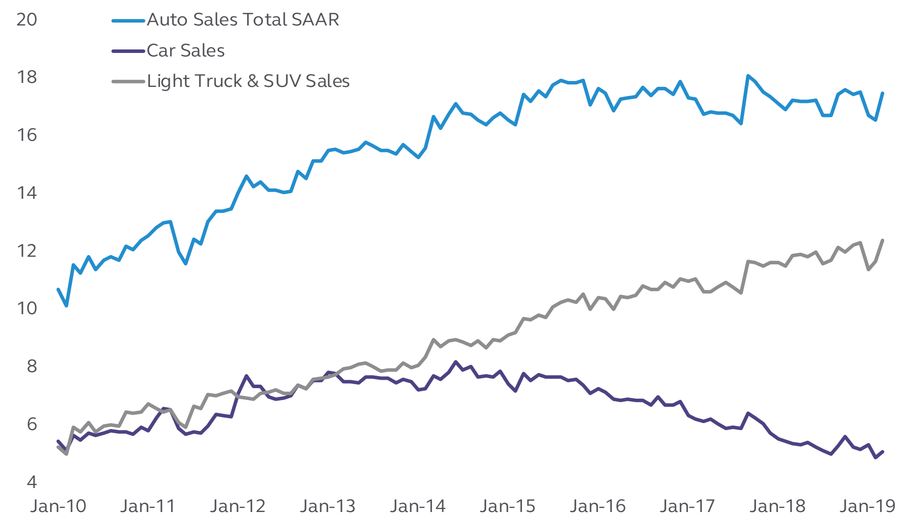
As population growth is a main driver of growth for any economy, the underlying trend of decelerating population growth and, by extension, the percent of population in the prime working age, presents a challenge to US economic growth rising above 2%.

Global Growth



Source: OECD Interimm Economic Assessment

Auto Sales



Source: Bureau of Economic Analysis, Bloomberg

Highlights

Global growth in 2018 is estimated to have been 3.6%. Estimated growth in the US accelerated to 2.9% while growth in the Euro area, Japan and China weakened.

Growth is expected to weaken in 2019. India and China are once again expected to be the fastest growing economies at 7.2% and 6.2%, respectively, though those numbers have been revised downward from earlier projections.

Outlook

With the outlook for global growth softening, central bank normalization policies have paused and will likely become more data dependent.

Highlights

During the 5 years following the financial crisis, total auto sales increased steadily year-over-year until 2015, at which time sales growth stagnated, and has remained flat through the first quarter of 2019.

In addition to the slowdown in overall sales, a clear divergence between car and light truck & SUV sales began to emerge at roughly the same time (2014). The divergence in vehicle type has continued to expand through 2019 wherein light truck & SUVs now account for roughly 70% of all vehicle sales.

Outlook

Given the current trends, and the higher price point of light trucks & SUVs over cars, we expect that total auto sales will remain flat through 2019 and will not be a driver of GDP growth for the year.

Macroeconomic Outlook

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Macroeconomic outlook offering a base case and two tail scenarios.

	Base Case (70%)	Tail 1 (20%)	Tail 2 (10%)
	Modest growth	**Prolonged weakness**	**Inflation / Stronger than expected growth**
	U.S. growth slows to 2.4% in 2019. The U.S. economy is growing faster than the other developed economies. China's growth slowed to 6.4% in the fourth quarter, marking the weakest rate since the global financial crisis. China has recently stimulated its economy, which seems to have slowed the deceleration. Growth in the second largest economy hurts other economies such as Germany, Japan and South Korea. Core PCE will stay near the Fed target of 2%. The U.S. and China make progress on the trade talks. After the trade talks the Trump Administration will revisit North Korea, with the expectation that China helps. The economy continues a historically long expansion. There are signs that autos are slowing, but housing is getting some relief from the drop in rates. The economy continues to grow as the Fed and the Trump administration avoid policy errors. Low global rates make U.S. term rates attractive and mute their rise. Interest rates will remain stable as the Fed is on hold and inflation is contained.	The global economy is slowing. China is slowing and stimulus is not effective in reversing the slower growth. The significant debt load that China carries leads to dislocations. Countries like Germany that export to China see their growth slow. Europe slows as it faces several headline problems: Brexit, lower exports to China, and the debt load of countries like Italy and Greece. Japan continues to grow slowly and implements the increase in the Vat tax (Value-Added Tax) to 10% in October, from the current 8%. The Fed raises rates too quickly and slows the economy. Market participants and business executives view the Fed hikes as a policy error and retreat from equities and business expansion. Stress in the corporate bond market tightens financial conditions. Market participants become concerned that a socialist leaning politician will take office in 2020 and create a business unfriendly environment.	Several of the concerns for economic growth have been eliminated or reduced. The Government shut-down is over. The Fed signaled to the markets that they would be on hold all year. The Mueller report was issued and it appears impeachment will be difficult. The markets have concluded that there will be a treaty with China. Brexit remains an issue with no obvious solution in sight. The markets seem to believe that any fallout will be contained within Europe. Japan postpones the Vat tax (Value Added Tax) increase, which removes a potential drag on the economy. Germany rebounds as trade worries recede. U.S. consumer and business confidence return to record levels. The threat of terrorist attacks is reduced and the Middle East problems improve. The North Korean threat is solved peacefully. The fast growing economy leads to higher inflation.
GDP	2.40% in 2019	Below 1.00%	Greater than 3.25%
Change in Rates	2Yr 2.35%, 10Yr 2.70%	Sharply lower / -125 bps (10Yr UST)	Sharply higher / +110 bps (10Yr UST)
Change in Curve	Curve slightly steeper	Bull flattener	Bear steepener
Volatility	Remains elevated	Higher	Higher