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MARKET COMMENTARY – JUNE 2018 *"The Hammer"*

Short term US Treasury rates moved higher and the yield curve continued to flatten in June, driven by a highly anticipated quarter point interest rate increase by the Federal Reserve. The statement released with the move indicates a Fed on cruise control, positioned to deliver a series of gradual rate hikes over the next 12-18 months toward a "neutral" policy rate that fosters growth with modest inflation. Also, the European Central Bank announced a tapering of its asset purchase program, the first step along the path of removing monetary policy accommodation.

Stocks and risk assets were mostly unchanged, albeit with more intra-month volatility as investors focused on multiple "hammers" beginning to affect markets – the removal of highly accommodative monetary policy in the US and Europe, increased prospects of a US-led trade war, and an aggressively flattening yield curve. Tech stocks were hit hard late in the month, as Trump announced initiatives that would block additional tech exports to China and restrict Chinese ownership in US technology companies.

The flattening yield curve is beginning to flash on radars everywhere, as the yield spread between 2 and 10 year treasuries, now 33 basis points, is approaching levels last seen just before the Financial Crisis. This is driven by Fed rate hikes, which hit short maturities more directly, while range bound longer term yields reflect investor concerns that the end of the bull market is in sight. An "inverted" yield curve, where a 2yr government bond yields more than a 10yr, pressures bank net interest margins, restricting lending, and has predicted 9 out of the last 10 US recessions.

The Fed released the results of its most recent bank stress test, with 17 out of 18 global banks passing. To almost nobody's surprise, Deutsche Bank failed, with the Fed citing "widespread and critical deficiencies across the firm's capital-planning practices". Where there's smoke, there's usually fire, and this is a situation to monitor.

Outlook:

We continue to look for the Fed to raise rates at a measured pace through 2019, ultimately achieving a "neutral" Fed Funds rate about 100 basis points higher, near 3%. This is an ideal environment for Qualified Settlement Fund mandates, as we expect short term yields to trend higher over the next 12-18 months on a very predictable path.

We believe stocks and other risk assets can continue to rally into the late stages of this bull market, but expect more volatility due to headwinds on several fronts. Growth and employment in the US are currently strong, but the "hammers" mentioned above increase the risk that the next recession will be pulled forward. Central banks are reversing the largest money printing experiment in history, bank profits are getting squeezed, and there are signs of trouble on the fringes.[1] Additionally, the risk of an exogenous event such as a trade war or a political crisis out of Europe has increased.

[1] http://arxmgmt.com/wp-content/uploads/2018/06/May-2018-Market-Commentary.pdf

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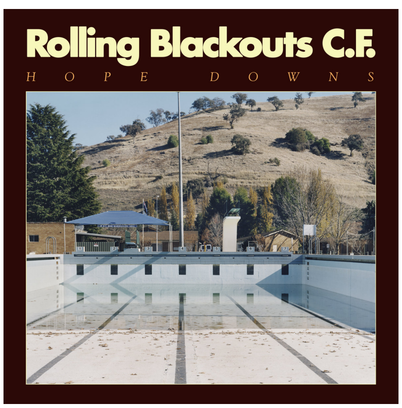
Market Snapshot:

	5/31/18	6/29/18	Change
Fed Funds Target Rate	1.50-1.75%	1.75-2.00%	+0.25%
3-month US Treasury	1.92%	1.92%	UNCH
2-year US Treasury	2.41%	2.53%	+12
10-year US Treasury	2.85%	2.86%	+1
30-year US Treasury	3.01%	2.99%	-2
S&P 500	2,746	2,718	-1.0%
Stock Mkt Volatility (VIX)	15.43	16.09	+4.3%
US Dollar (DXY)	94.07	94.58	+0.5%
Oil	$67.04	$74.39	+11.0%
Gold	$1,305	$1,255	-3.8%
Bitcoin	$7,487	$5,892	-21.3%



This month's featured song is "The Hammer" by Rolling Blackouts, Coastal Fever. Enjoy!

https://open.spotify.com/track/3Uf1tj7lroXfC9BlEEUfpv?si=Pm2rwR_wRjGvZ1WLhUxAyA

About ARX Management:

Established by professionals with direct experience in complex litigation and institutional investment management, ARX offers an unmatched mix of expertise relevant to managing 1.468B Qualified Settlement Funds. Prior to establishing ARX in 2011, our partners actively managed $8 billion in fixed income assets for a large institutional investment manager. Our expertise investing conservative capital preservation products is directly applicable to the management of institutional QSFs. Contact us today.

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