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AUGUST 2018 MARKET COMMENTARY *"Jackson"*

Minutes from the June FOMC meeting and Jerome Powell's first Jackson Hole speech as Fed Chairman show a Fed poised to keep raising rates, but perhaps not in the robotic fashion investors have become accustomed to. The minutes indicated that consistent quarterly rate increases aren't baked in the cake, citing risks such as trade, emerging markets volatility, and US data beginning to show a more mixed picture. Powell's comments focused on the risk of a trade war, as well as the challenges of removing unprecedented monetary accommodation – remember, this tightening cycle started with rates at 0% and the Fed holding roughly 20% of outstanding US Government-guaranteed debt on its balance sheet[1]. Consider that monetary policy works with a 6 to 12 month lag, and the Fed is already nervous about its ability to identify a "neutral" rate, one which fosters economic growth with inflation near 2%, at which to stop tightening.

The treasury curve continues to twist and flatten, led by short-term yields marching higher in anticipation of rate hikes while long term rates remain sticky around the 3% level. The 2s-10s Treasury spread narrowed from 29 to 22 basis points during August. There is some chatter that the yield curve's record of predicting recessions doesn't count this time, due to the unprecedented steps central banks took during the Financial Crisis. If anything, we believe the recoil from an expansion driven by unconventional policies could be more extreme than a run of the mill recession. The San Francisco Fed published a great paper on this topic (link attached on page 2), and we also concur that it's <u>not</u> "different this time".

Equities continued to race higher as the S&P 500 gained 3.0% in August, marking the longest bull market in US history. It's interesting to note that since March 2009, the S&P 500 has tripled while the US economy has grown just 22% - think about that. Market volatility (VIX) was unchanged despite these red flags – i) currency-driven political instability in Turkey, Venezuela, and Iran; ii) risks related to US trade policy; iii) US data starting to turn weaker, and; iv) the yield curve! Next up, we'll be discussing the massive and rapidly growing debt burden here in the US.

Outlook:

We expect the Fed to announce another quarter point increase on September 26th to 2-2¼%. While Chairman Powell's Jackson Hole comments and the Fed minutes raise doubts about a rate increase every quarter, we still see the Fed achieving a "neutral" rate next summer or fall near 3%. As the yield curve continues to flatten and exogenous risks multiply, we believe we are close to the end of the bull market.

This is still an ideal environment for actively managed Qualified Settlement Funds, with short term government-guaranteed bonds offering very attractive yields with minimal interest rate and zero credit risk – about as close to a free lunch as you can get.

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[1] Q1 2017, per the Securities Industry and Financial Markets Association.

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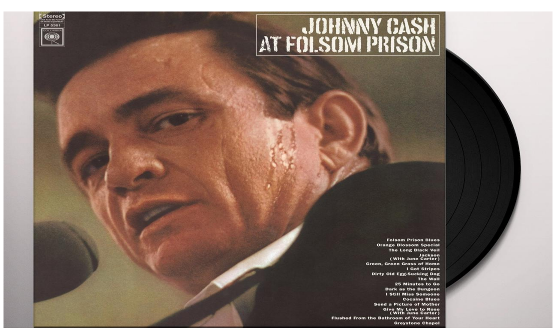
	7/31/18	8/31/18	Change
Fed Funds Target Rate	1.75-2.00%	1.75-2.00%	UNCH
3-month US Treasury	2.03	2.10	+7
2-year US Treasury	2.67	2.63	-4
10-year US Treasury	2.96	2.85	-11
30-year US Treasury	3.08	3.01	-7
S&P 500	2,816	2,901	+3.0%
Stock Mkt Volatility (VIX)	12.83	12.86	UNCH
US Dollar (DXY)	$94.49	$95.10	+0.6%
Oil	$68.76	$69.88	+1.6%
Gold	$1,233	1,212	-1.7%
Bitcoin	$7,724	$7,013	-9.2%

Check out the San Francisco Federal Reserve's excellent paper on the flattening yield curve:

https://www.bloomberg.com/news/articles/2018-08-27/fed-paper-questions-this-time-is-different-yield-curve-theory

Check out the ARX Spotify Playlist, this month featuring "Jackson" by Johnny Cash:

https://open.spotify.com/user/brownarxmgmt/playlist/1N8OIeXUpHsYKRQVqiHn04?si=DmTA9NW0REK5I8nvIp95OQ



About ARX Management:

Established by professionals with direct experience in complex litigation and institutional investment management, ARX offers an unmatched mix of skills 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 at arxadmin@arxmgmt.com.