We delayed publishing the July Fixed Income Review so we can present fresh data and comment on the surge in volatility following the Fed meeting (7/31) and new tariffs on China (8/1).

In general, the fixed income markets were mostly sleep-walking through July in anticipation of a July 31st Federal Reserve rate cut and a much-anticipated dovish statement from the Fed. As if on autopilot, stock markets slogged higher and credit spreads moved tighter throughout the month. Meanwhile, Treasury yields rose modestly after their dramatic declines in May and June. Indeed, as the table below reflects, Treasuries were the only major fixed-income class to lose ground on a total return basis in July. All other categories posted positive returns for the month.

RIA Pro	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return	Current Yield to Worst	YTW Change
U.S. Aggregate	0.22	3.28	6.20	8.08	2.52	0.02
Agg. Treasury	-0.12	3.17	4.99	7.57	2.01	0.09
Agg. Investment Grade - Corp.	0.56	4.43	10.06	10.04	3.16	0.00
Agg. High Yield - Corp.	0.56	1.63	10.20	6.92	5.88	0.01
Agg. Securitized (ABS, MBS, CMBS)	0.38	2.47	4.63	6.71	2.65	-0.03
Agg. Investment Grade - Muni.	0.81	2.57	5.80	7.31	1.89	-0.14
Agg. Emerging Markets	1.00	4.37	10.07	9.89	4.81	-0.07
Data as of 07/31/2019						

In stark contrast, the ETF table below highlights some of the significant changes we have seen since the beginning of August.

RIA Pro	Thru Aug. 9	MTD Total Return	3 Month Total Return	YTD Total Return	12 Month Total Return
AGG (U.S. Aggregate)	1.44%	0.18%	3.22%	6.04%	7.94%
GOVT (Agg. Treasury)	1.80%	-0.01%	3.25%	5.65%	7.55%
LQD (Agg. Investment Grade - Corp)	1.58%	0.25%	5.22%	12.21%	11.41%
HYG (Agg. High Yield - Corp.)	-0.36%	0.16%	1.32%	10.08%	6.53%
MBB (Agg. Securitized (ABS, MBS, CMBS)	0.43%	0.37%	2.39%	4.54%	6.74%
MUB (Agg. Investment Grade - Muni.)	0.97%	0.73%	2.57%	5.60%	7.04%
EMB (Agg. Emerging Markets)	1.03%	0.73%	4.80%	6.45%	10.45%
Data as of 8/9/2019 & 7/31/2019					

Following the Federal Open Market Committee (FOMC) meeting on July 31 and the subsequent press conference delivered by Chairman Jerome Powell, the future of monetary policy was suddenly in question. For the first time in several months, the Fed failed to deliver a dovish surprise.

Part of Powell?s response to the first question in the press conference regarding the ?hurdle? for further rate cuts was as follows:

??the committee is really thinking of this as a way of adjusting policy to a somewhat more accommodative stance to further the three objectives that I mentioned. To ensure against

downside risks, to provide support to the economy that those factors are pushing down on economic growth and then to support inflation. So, we do think it'll serve all of those goals. But again, we're thinking of it as essentially in the nature of a midcycle adjustment to policy.?

Despite the evidence and assurances of rate cuts to provide a firebreak against any potential weakening of the economy, Powell?s reference to ?*a midcycle adjustment*? suddenly raised doubts about their conviction for further easing.

Given the strength of the U.S. economy, the ?*downside risks*? he refers to are clearly emanating from foreign sources. Now add a Fed that may not be ready to cut rates further and the renewed escalation of the trade war between the U.S. and China and one has a potent cocktail for the volatility seen since the end of July.

As can be seen in the tables above, fixed-income markets in July were mostly a non-event but the first several days of August have been full of fireworks. The table below illustrates the move in U.S. Treasury yields since July 31.

Yield	7/31/2019	8/9/2019	Change
2 Year Treasury Yield	1.87%	1.65%	-0.22%
10 Year Treasury Yield	2.01%	1.75%	-0.26%
2-10 Year Treasury Spread	0.14%	0.10%	-0.04%

Investment grade and high yield markets reacted with some displeasure to Jerome Powell?s comments and new rhetoric from the administration on trade and tariff challenges associated with China. Although the magnitude of the spread changes did not breach any meaningful technical levels, the speed of the change was rather head-snapping.

OAS (bps)	7/31/2019	8/9/2019	Change
Investment Grade (IG)	108	120	12
High Yield (HY)	371	415	44
IG-HY Spread	263	295	32

We end up in a familiar place. If we are to take the Chairman at his word and potential downside risks warrant a rate cut, it becomes even more challenging to justify the valuations investors are being asked to pay to own risky assets. Despite having posted new highs in recent weeks, the S&P 500 has produced a 3.48% annualized total return over the past 18 months along with volatility of 15.5%. High yield bonds have delivered annualized total returns of 4.80% with 12.9% volatility. Net out the most recent inflation data of 1.6% from those numbers and we struggle to understand why investors have been so enthusiastic.

Eighteen months ago, one could buy 10-year Treasuries at a 2.85% yield. The 7-10 year ETF (Ticker: IEF) has delivered 3.55% total return and with only 4.4% volatility. Needless to say, while not glamorous, the risk-free route provided returns on par with stocks and high-yield but with *significantly* less volatility. Given the risks Chairman Powell has outlined, might Treasuries, despite near-record low yields, be the safe place to hide in fixed income for the time being? Astute, rational investors will either figure that out on their own or the market will impose its will.

All Data Courtesy Barclays