ALAMO CAPITAL
INVESTMENT SERVICES

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Key Fixed Income Economic Topics For 2018

By Carolie Smith, *Vice President*

Now that the Federal Tax Bill has begun to be implemented and we are settling into 2018, let's review some expected themes for this year as they relate to the fixed-income markets.

1. **Tax Reform Will Boost Growth Domestically and Worldwide**

Economists are saying that, yes, the tax reform bill will boost the economy in the U.S. as well as worldwide. Recent data has indicated that Global Growth may be over 3.0% this year. I've heard some say as high as 3.9%. Of interest to note is that some European companies are liquidating part of their European investments and moving into opportunities they see in the U.S. However, some economists have noted concerns over the new Tariffs being implemented. Their concern is that additional tariffs may squelch some of the expected growth. In addition, the anticipated immigration restrictions, along with a stronger economy, will cause labor shortages. It's anticipated that the unemployment rate may fall below 3.5% this year.

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2. Core Inflation Will Rise Modestly

There was a drop in the core inflation (CPI) in 2017 (from 2.3% down to 1.7%). However, inflation is a lagging indicator behind private sector economic activity by as much as 6 quarters. It's expected that inflation will accelerate further in 2018 and will probably return to the Fed's 2% target by the end of 2018.

3. The Fed May Hike Rates Two to Four Times

The markets have already priced in about two Fed rate hikes in 2018 (10 yr Govt today is 2.7% compared to 2.4% end of December). The FOMC currently projects three rate hikes. If the financial conditions remain highly accommodative, the Fed may have room to raise four times this year. It all depends if they continue their view of full employment being 4.6%.

4. The Yield Curve Will Flatten as the Fed Keeps Hiking Rates

The muni yield curve has already been flattening and it's expected to continue to flatten as the Fed raises rates. The short and intermediate (1-10 years) year rates will rise, and it's expected that the 12 to 30-year maturities will not experience the same degree of rate change, therefore, a flat yield curve.

5. Recession Concerns Will Grow as the Fed Keeps Hiking Rates

Historically, the continued flattening of a yield curve indicated a recession was on the horizon. The Fed, seeing an overheated labor market and rising inflation which will raise rates, and may lead to recession concerns going into 2019.

6. Record Corporate Debt Levels Will Come into Focus

We at Alamo Capital have already heard rumblings about the amount of corporate debt levels. The ratio for U.S. non-financial corporate liabilities to GDP is almost at 100%; the previous record 2001 was at 93%. With spreads tightening over the past 3 years, investors may not be adequately compensated for the credit risk taken. Talk with your Alamo Capital Representative if you have concerns. Perhaps this year is the time to consider upgrading the credit quality of your corporate bond portfolio.

Check with your Alamo Capital Sales Representative if you'd like to discuss rebalancing your portfolios.

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