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MARKET REVIEW
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ATG TRUST
C O M P A N Y

LISTEN UP! BONDS HAVE SOMETHING IMPORTANT TO SAY.

As summer comes to its eventual end, the parade of strong economic data continues and major domestic stock indexes are back to, or even above, their all-time highs set back in January. With all the focus on the good news in both stocks and the economy, it is important to remember that the bond market can offer insights as well. There are some who consider the signals from the bond market to be just as important, or even more so, than those from stocks. It behooves us to pay attention as well. This Market Brief interprets the latest signals from the bond market by considering real, or inflation-adjusted, yields and the slope of the yield curve. Let's listen.

NOMINAL VS. REAL YIELDS

Many a bond buyer has been heard wishing for the "good ol' days" of the late 1970s and early 1980s. Back then, yields on 10-year U.S. Treasury Notes (US10) ranged mostly between 10-12%, but did get as high as 15%. Yields that high are practically unheard of in today's domestic markets, even in high yield bonds.

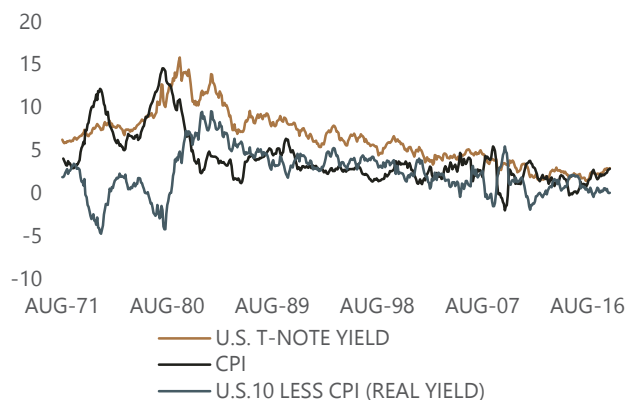
However, it has also been said that "it's not what you make, but what you keep" and for bond investors what you "keep" is your yield, less inflation. The chart on the top of page three (left) shows US10 yields, inflation and a real yield equal to the US10 yield less inflation. During that same period mentioned above, real yields were as low as -4% and as high as 8%.

Beginning in the mid 1980s and continuing to the present, real yields have fallen from about 9% to nearly zero today, with periods of negative yields emerging briefly in 2008, 2011, and 2012. Many investors consider the last 40 years of data and broadly infer that real yields on US10s range from 2-4%. Despite that generalization, bonds have more to say.

Why would real bond yields vary so greatly over time? And why would they ever be negative? Economic growth and inflation are the answer. If bond investors are indeed a cautious bunch, they would own fewer bonds when inflation expectations are rising (their selling pushes rates higher) because future coupon payments will be worth less after inflation. Conversely, they would own more when inflation expectations are falling (their buying pushes rates down). Since bond prices and yields adjust at differing speeds compared to growth and inflation expectations, real yields in the lower end, or below the inferred 2-4% range, could indicate bondholders believe growth and/or inflation rates may be low or decline in the future. When yields are at the high end or above this range, bondholders likely believe growth and inflation may remain elevated or accelerate. The message from today's near-zero real bond yields could be that economic growth and inflation might not have much room to expand further.

U.S. T-NOTE REAL YIELDS

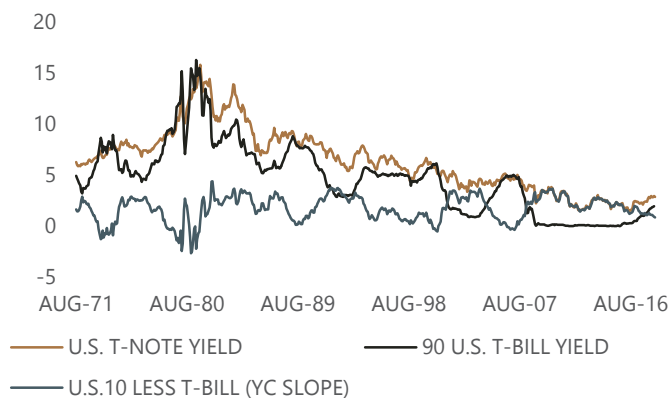
1971 THROUGH JULY 2018



Source: St. Louis Federal Reserve Bank, FRED Database

HISTORICAL YIELD CURVE SLOPE

1971 THROUGH AUGUST 2018



Source: St. Louis Federal Reserve Bank, FRED Database

SLOPE OF THE YIELD CURVE

Bond yields rise as the term to maturity lengthens in order to compensate investors for the longer holding period because the risk of issuer default grows over time. When viewed together, the yields of most common maturities, (30, 90, 180 days, and 1, 2, 5, 10 and 30 years) are formally referred to as the term structure of interest rates. Informally, this relationship is called the yield curve.

Though not shown, most investors have heard about the upward slope to the yield curve. However, over long enough time periods, and through multiple business cycles, the steepness (difference between short and longer yields) varies. The chart above (right) shows the changing slope of the yield curve by subtracting 90-day U.S. T-Bill yields from US10 at monthly intervals over the past 40 years.

Historically, recessions have typically occurred soon after the yield curve becomes flat or negative. For example, the recession that began in late 2007 was preceded by flat and negative yield curves around August 2006.

The yield curve has been declining since mid-2010 as yields on the US10 began falling, but the Federal Reserve kept short-term rates at, or near, zero. As the Fed has continued to raise rates in 2017 and 2018, 90-day T-Bill yields have crept higher while the US10 has not really budged. If these trends continue, a flat or inverted yield curve could result. The slope of the yield curve might not be shouting a recession is near, but it certainly looks like it could occur in the next couple of years.

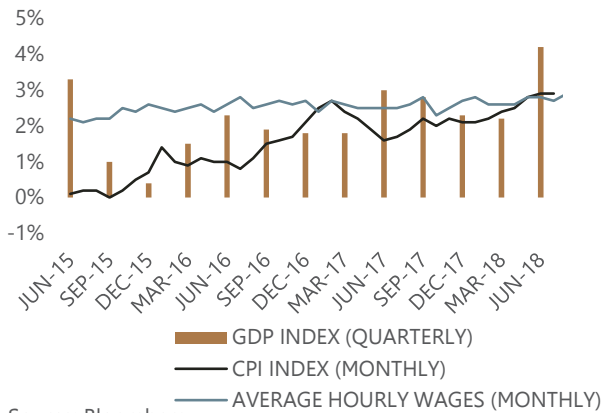
CONCLUSIONS AND INVESTMENT IMPLICATIONS

This publication has recently argued both that economic expansions are lengthening and that the markets may have missed a mild recession in 2015-2016. We believe sound money management involves listening to a broad swath of indicators, and the message from the bond market, though not yet downright bearish, is at best complacent and at worst cautionary.

Economic data in late August depicted on the following pages show signs of accelerating inflation. It would be unusual for the U.S. economy to experience economic growth rates in excess of the recently observed 4% pace for more than a few quarters without stoking inflation. According to federal funds futures, market participants believe there is a 96% probability of an interest rate increase in September. Declining real yields and the slope of the yield curve may be the warning bell investors should be prepared to hear.

ECONOMY

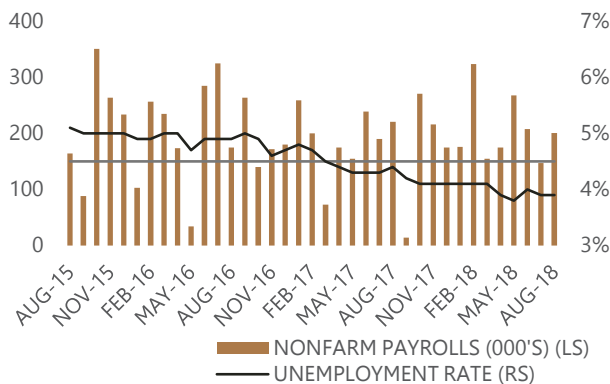
GDP, CONSUMER PRICES AND WAGE INFLATION JUNE 2015 THROUGH JULY 2018



Source: Bloomberg

- Second quarter U.S. GDP growth was revised higher to a 4.2% annualized rate up from 4.1%. Stronger business spending and a lower import bill offset a small downward revision to consumer spending.
- The Core Personal Consumption Expenditure (PCE) price index, the Fed's preferred inflation measure, increased by 0.2% after rising 0.1% in June. The year-over-year reading for Core PCE rose to 2.0%.
- Core Consumer Price Index (CPI), which excludes volatile food and energy costs, rose 0.2% in July. The year-over-year number for Core CPI rose to 2.4%.

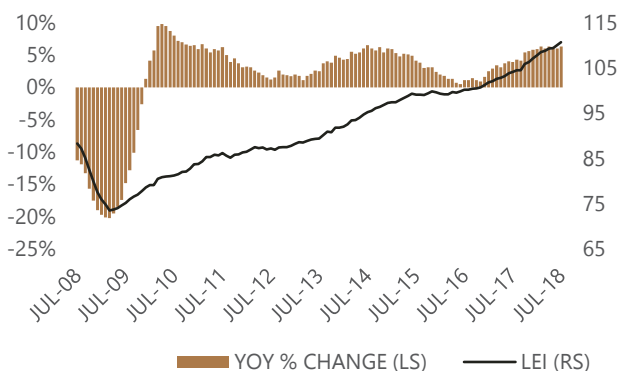
LABOR MARKET AUGUST 2015 THROUGH AUGUST 2018



Source: Bloomberg

- U.S. nonfarm payroll employment rebounded significantly from its downward revised figure of 147,000 jobs in July, adding 201,000 new jobs in August. This exceeded economists' consensus estimate of 190,000.
- The unemployment rate remained unchanged at 3.9%, slightly above its lowest level since 1969.
- Average hourly earnings increased 2.9% year over year, a growth rate not seen since 2009. Rising wages could add upward pressure on inflation, which will give the Fed further support to continue raising interest rates.

LEADING ECONOMIC INDICATORS JULY 2008 THROUGH JULY 2018



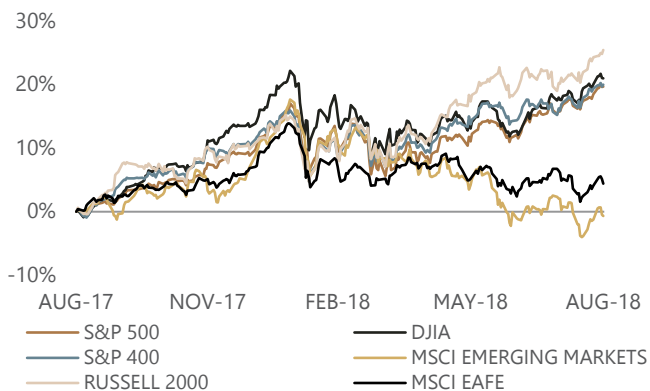
Source: Bloomberg

- The Conference Board LEI is comprised of ten economic components, and is considered a helpful gauge for estimating economic activity for the subsequent three to six months. The LEI index increased 0.6% in July to 110.7, building on gains of 0.1% and 0.5% in May and June, respectively.
- The increase in the LEI comes from a growing list of contributors, including interest rate spreads, low unemployment claims and stock prices, to name a few. Six of the ten indicators that comprise the index increased in July.
- The LEI index's year-over-year growth accelerated to 6.3%, up from 6.0% in June. The acceleration suggests the economy could experience continued momentum.

EQUITY

TRAILING 12-MONTH EQUITY RETURNS

PRICE APPRECIATION, AUGUST 2017 THROUGH AUGUST 2018

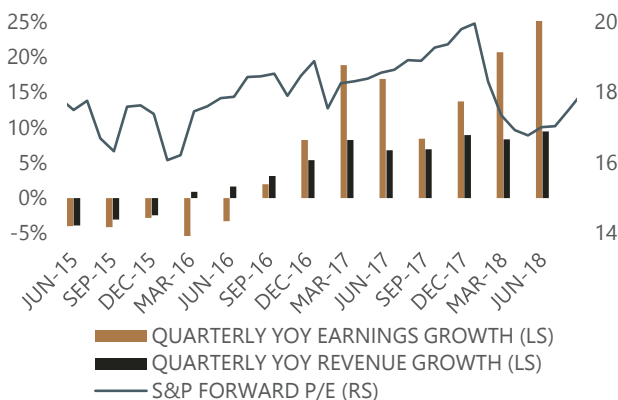


Source: Bloomberg

- The resilience of the U.S. economy propelled domestic stocks to another strong month despite the ongoing trade conflict with China and currency crisis in some emerging market countries. The S&P 500 gained over 3.0% for a second consecutive month. The greater domestic focus of small cap stocks helped the Russell 2000 index lead all major stock indexes with a 4.3% gain.
- The MSCI Emerging Market index fell 2.7% last month amid concerns about weakening currencies and high levels of dollar denominated debt in a few countries.
- Concerns about banking exposure to emerging market countries weighed on stocks in Europe. The MSCI Europe index declined 3.2% while the MSCI Europe Bank index fell 8.6%.

S&P 500 YOY EARNINGS & REVENUE GROWTH

BY QUARTER, JUNE 2015 THROUGH AUGUST 2018

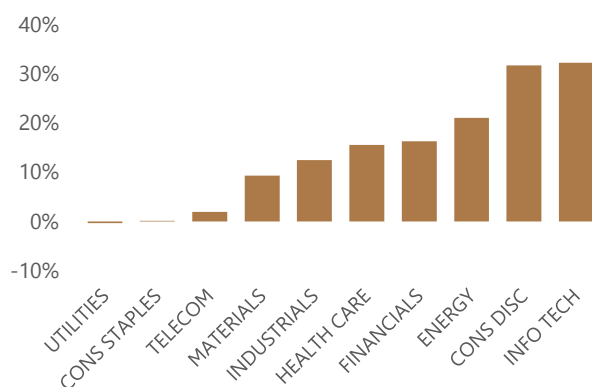


Source: Bloomberg

- Second quarter earnings reporting season is almost complete with results reported from 99% of S&P 500 companies. S&P 500 earnings and sales growth are on track for 25% and 10%, respectively. The last time earnings and sales grew at least 25% and 10% simultaneously was in the second quarter of 2004.
- Analysts are forecasting continued strength this year with earnings growth around 30% in Q3 and Q4 and sales growth around 7% in both quarters. Analysts expect growth next year will be slower, but still healthy. Earnings and sales growth are forecasted to decelerate to 10% and 5%, respectively, in 2019.

S&P 500 SECTORS 12-MONTH RETURNS (PRICE)

AUGUST 2017 THROUGH AUGUST 2018



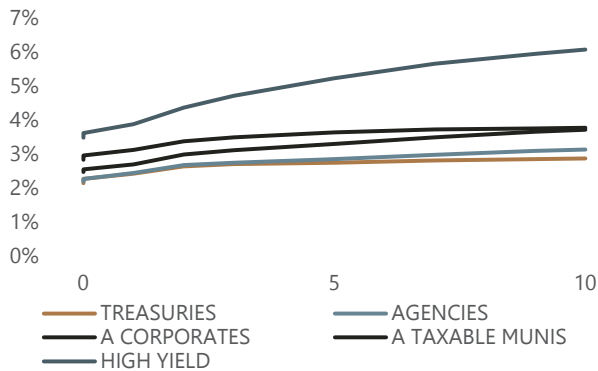
Source: Bloomberg

- The health care sector has experienced a strong rally in recent months that has resulted in a three-month return of 13.1% which is the best among the eleven sectors. The sector has benefitted from better-than-expected second quarter earnings and upward revisions to analysts' forecasts.
- Energy and materials were the only sectors with a monthly loss in August. Energy stocks were pressured by the price of oil falling 4.6% amid concerns global trade wars could reduce oil demand and OPEC's monthly oil output reached a 2018 high. Weak economic data from China and the trade dispute between the U.S. and China weighed on the demand outlook for materials.

FIXED INCOME

CURRENT YIELD CURVES

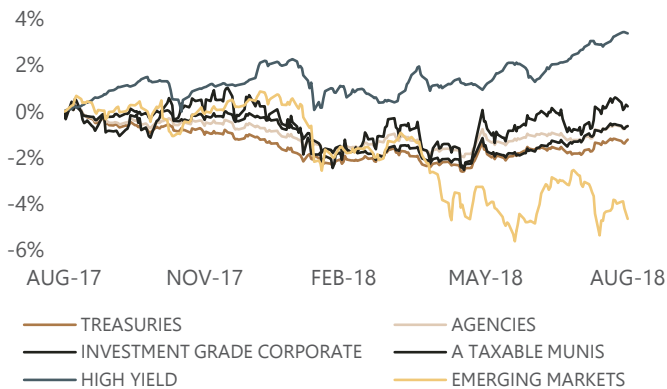
YIELD CURVES AS OF AUGUST 2018



Source: Bloomberg

- The U.S. Treasury yield curve flattened further in August, falling from a yield differential of 32 bps all the way down to 18 bps before settling at 24 bps by the end of August.
- A decline in the 10-year U.S. Treasury yield contributed to the flatter curve as 10-year inflation breakevens declined during the month. A slightly higher 2-year Treasury yield also contributed to the flatter curve.
- The San Francisco Fed noted the difference between 10-year and 3-month yields is a more accurate recession indicator than the difference between 10-year and 2-year yields. This should placate curve inversion concerns because the 10-year minus 3-month yield is currently three times higher.

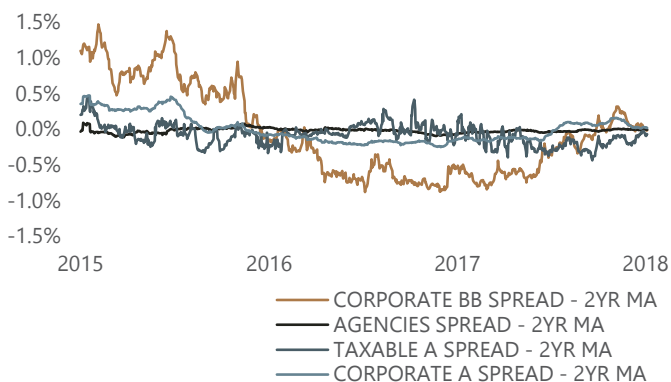
12-MONTH RETURNS, TAXABLE BOND SEGMENTS AUGUST 2017 THROUGH AUGUST 2018



Source: Bloomberg

- High yield bonds continue to display strength over the rest of the fixed income market with a 12-month return of 3.4%. The next closest segment was municipal bonds with a return of 0.2%.
- High yield and municipal bonds were the only bond asset classes with positive 12-month returns while U.S. Treasuries, agencies, investment grade corporates, and emerging market bonds all had negative 12-month returns.
- In the month of August, every bond asset classes' 12-month yield increased by at least 0.5% except for Emerging Markets which decreased by 1.9%.

SPREAD VS. TREASURY LESS 2-YR MOVING AVG AUGUST 2015 THROUGH AUGUST 2018

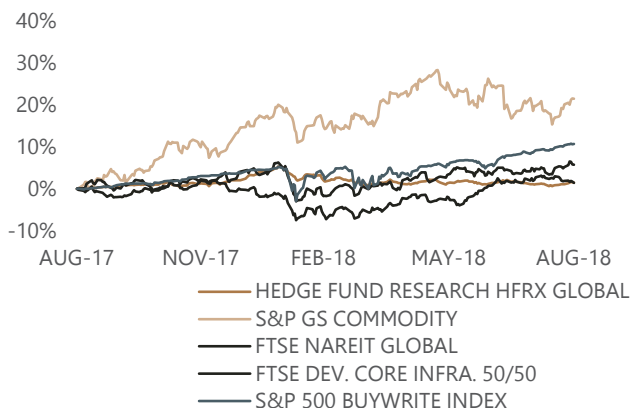


Source: Bloomberg

- After significantly tightening in July, corporate spreads remained tight in August, and A-rated corporates continued to tighten slightly.
- Given the low corporate spread level, investors have little room to benefit from further spread compression, and venturing lower in credit quality provides little additional reward for the added risk.
- In addition to taxable spreads being tight, tax exempt municipal bonds at the short end of the curve have grown exceedingly rich relative to similar-dated U.S. Treasury bonds in recent months. The yield on a AAA-rated two-year general obligation municipal bond is now just 64% of a similar-dated Treasury compared to 74% on May 31.

ALTERNATIVES

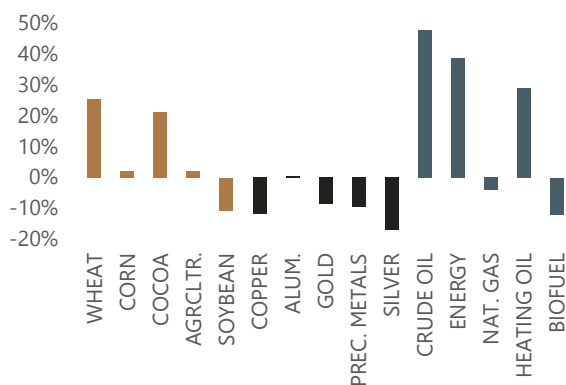
ALTERNATIVES, 12-MONTH RETURNS AUGUST 2017 THROUGH AUGUST 2018



Source: Bloomberg

- All five alternative asset classes tracked in the chart at left outperformed the Bloomberg Barclays Aggregate Bond Index's -1.1% total return over the twelve-month period ending August 31. The S&P GSCI market-weighted commodities index outperformed the S&P 500 Index's 19.7% over this period, boosted by the ascent of U.S. crude oil prices from \$47 per barrel to \$70 per barrel.
- The HFRX Global Index has posted minimal gains thus far in 2018, weighed down by strategies in the following groups: short-bias, distressed restructuring, special situations, agricultural commodities, metals commodities and trend-following. Energy commodities, activist strategies and energy sector relative value have been among the top performing HFRX groups year to date.

COMMODITIES, 12-MONTH SPOT RETURNS AUGUST 2017 THROUGH AUGUST 2018



Source: Bloomberg

- Soybean prices resumed their downward trend in August dropping below \$8.50 per bushel despite the Trump administration's July 25 announcement of \$12 billion in emergency aid to U.S. farmers hurt by European and Chinese tariffs.
- Gold prices have declined 11.2% from April 11 to August 31 against a backdrop of gradual U.S. Federal Reserve interest rate hikes and a strengthening U.S. dollar. Because gold is bought and sold in U.S. dollars, its price typically declines when the greenback strengthens.
- U.S. dollar strength has been a headwind for most commodities in 2018, outside of crude oil. A Bloomberg index that tracks the trade-weighted dollar has advanced 3.3% year to date after declining 10.0% in 2017.

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