Bond Market Update

As of September 30, 2017 / Volume 6, Issue 3 / FFTAM.COM

The 3rd Quarter of 2017 for the fixed income market saw three hurricanes hit the U.S., a Federal Reserve that announced an October start date for balance sheet reduction, and a published blueprint for tax reform by the White House. The Federal Reserve (the Fed) did not raise the overnight rate in the 3rd quarter, reinforced its communication of gradualism, and disseminated its plan of balance sheet reduction. The U.S. economy continued its slow and bumpy growth trajectory. The GDP forecast for the 3rd quarter is projected to come in at 2.60%. For the quarter, both the AAA taxable yield curve and the tax-exempt yield curve flattened.

Total returns for taxable and tax-exempt investments were positive. For the 3rd quarter, the Barclays Aggregate Bond Index recorded a total return of 0.85% and the Barclays Muni Index recorded a total return of 0.73%. YTD returns are 3.14% and 3.72%, respectively. As mentioned above, the economy continued its slow and bumpy growth trajectory as 2nd quarter GDP came in with a final growth reading of 3.10%. ISM Manufacturing saw increased readings each month, with all readings above 50. ISM Nonmanufacturing continued their readings above 50 (a reading above 50 indicates expansion). The unemployment rate ticked down to 4.20% from 4.40% and the labor force participation rate edged up slightly to 63.1% from 62.8%. The quarterly average growth in jobs produced on average 91k a month. Average hourly earnings increased to a 2.90% year over year pace.

While three hurricanes filled the news channels and caught the attention of America, the main fixed income event in the 3rd quarter was the formal announcement of the balance sheet reduction by the Federal Reserve and the blueprint for tax reform by the White House. The Fed Funds rate stayed at a range of 1.00% to 1.25%. Recent indications by the Chairwoman herself, are for one more hike this year as the inability of inflation to reach the Feds 2% target is still viewed as transitory. As it relates to the Fed's $4.5T balance sheet, the 4th quarter will see a reduction in Treasuries of $6B/month and MBS's $4B/month, increasing each quarter until all reinvestment has subsided.

Below to the left is the U.S. Treasury Yield curve as of 12/31/16 and 09/30/17. As you will see, the yield curve has flattened since the beginning of the year. Below to the right is the AAA Municipal Yield curve as of 12/31/16 and 09/30/17. As you will see, the yield curve has flattened since the beginning of the year.

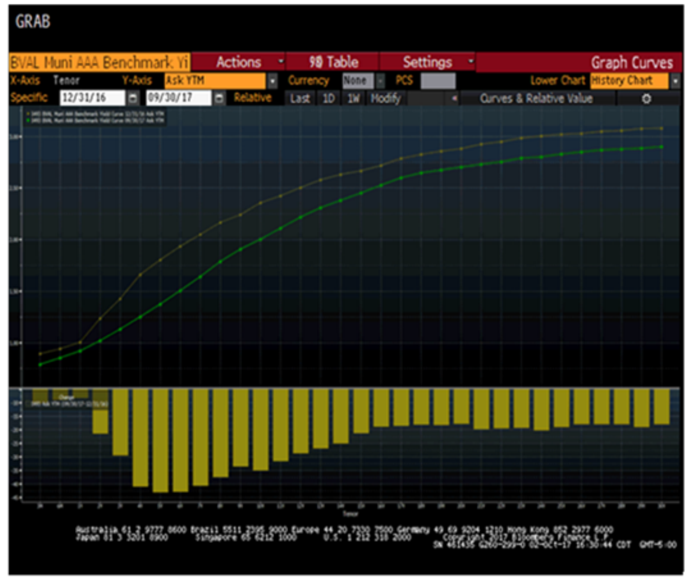
FFTAM Office Locations

Abilene	Fort Worth	Stephenville	San Angelo	Sweetwater	Odessa	Beaumont
400 Pine Street	1000 Forest Park Blvd	2201 W. South Loop	301 West Beauregard	201 Elm Street	3555 Billy Hext Rd	3515 Dowlen Road
Suite 300	Suite 200	Stephenville, TX 76401	San Angelo, TX 76903	Sweetwater, TX 79556	Odessa, TX 79765	Beaumont, TX 77706
Abilene, TX 79601	Fort Worth, TX 76110	(254) 918-6262	(325) 659-5987	(325) 235-6644	(432) 367-8912	(409) 600-6460
(325) 627-7100	(682) 703-6404					

First Financial Trust & Asset Management Company NA

Bond Market Update

As of September 30, 2017 / Volume 6, Issue 3 / FFTAM.COM



For the quarter and year, investment grade credit spreads were marginally tighter (unchanged for the Quarter and 19bps YTD) and high yield credit spreads were marginally tighter (2bps for the Quarter and 59bps YTD) versus the risk free rate.

Looking forward, the Fed is walking a tight rope of trying to tighten monetary policy by raising the Fed Funds rate in the face of 2% annualized GDP growth. In addition, the balance sheet reduction starting in October will be viewed as nontraditional monetary policy tightening. If the Fed raises rates in December and projected growth rates stay the same, the risk of a policy error escalates. Of course, tax reform does have the ability to counteract Fed tightening to some degree. Rates should have a bias to rising in the short term. In short, we remain committed to a very high credit quality portfolio with a slight tilt towards credit risk in the short term. As opportunities present themselves, we may selectively change our portfolio composition to take advantage of higher interest rates.

FFTAM Office Locations

Abilene	Fort Worth	Stephenville	San Angelo	Sweetwater	Odessa	Beaumont
400 Pine Street	1000 Forest Park Blvd	2201 W. South Loop	301 West Beauregard	201 Elm Street	3555 Billy Hext Rd	3515 Dowlen Road
Suite 300	Suite 200	Stephenville, TX 76401	San Angelo, TX 76903	Sweetwater, TX 79556	Odessa, TX 79765	Beaumont, TX 77706
Abilene, TX 79601	Fort Worth, TX 76110	(254) 918-6262	(325) 659-5987	(325) 235-6644	(432) 367-8912	(409) 600-6460
(325) 627-7100	(682) 703-6404					

FIRST FINANCIAL TRUST & ASSET MANAGEMENT COMPANY NA