January 2019

OREGON STATE TREASURY

Inside the Vault

Local Government Edition

A New Treasury Brand

With the new year comes a new look for Treasury. Our new brand is the outward expression of our purpose. Through its use of arrows pointing upward, Treasury's new logo conveys progress and constant improvement. It can also be viewed as representative of a pine tree, an allusion to the natural beauty of Oregon. The arrows are contained within a t-shaped symbol, which stands for "Treasury" and, through its balance and weight, suggests stability and strength.

Over the past few weeks, you have seen our new brand start to populate across our communications. Treasury recently launched a wholly redesigned website, and this newsletter has been both redesigned and renamed: it's now called *Inside the Vault—Local Government Edition*. We hope you take time to explore our new website, and look for our new brand to continue to unfold over the coming weeks and months.

Credit Market Review

The fourth quarter of 2018 was one for the record books. Global economic data showed signs of weakening, trade tensions between the United States and China escalated, and the Federal Reserve continued to tighten monetary policy by hiking rates and shrinking its balance sheet. Those factors, combined with lofty risk-asset valuations, led to a rapid repricing of risks assets. U.S. stocks, as measured by the Standard & Poor's 500 Index, declined 13.52 percent in the quarter to end the year down 4.38 percent. Investment-grade credit markets also struggled for the year with the Bloomberg Barclays U.S.

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Interest Rates

Average Annualized Yield

December	2.5645%

Interest Rates

December 1–23	2.50%
December 24–31	2.75%

Upcoming Holiday

The pool will be closed on Monday, January 21, for Martin Luther King, Jr. Day. EON will be available but the system will not allow transactions to settle on the holiday.

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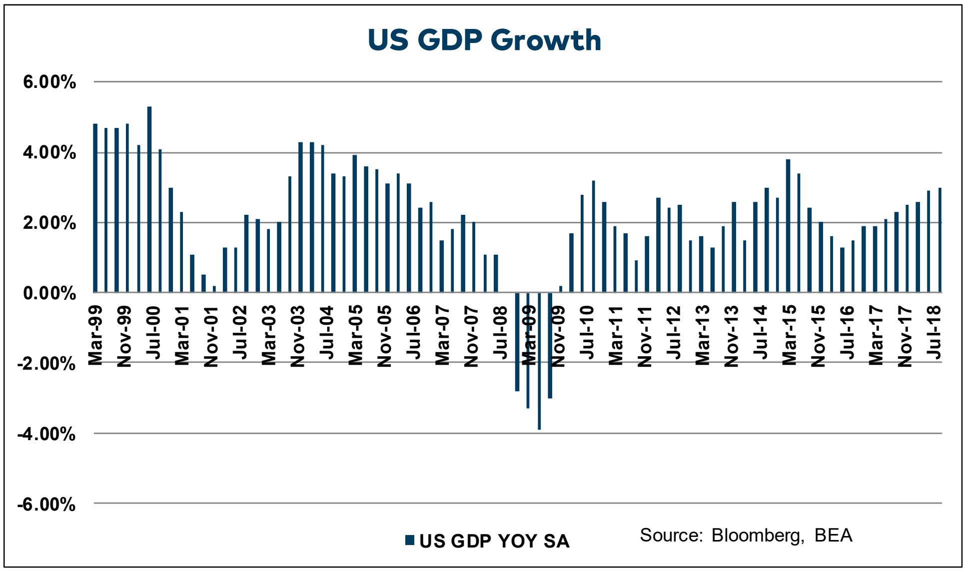
Corporate Index ending the year down 2.51 percent as corporate credit spreads widened out in the fourth quarter. Shifting back to U.S. stocks, the decline in the fourth quarter marks the third-worse fourth quarter in the post-war era—trailing only the declines in 1987 and 2008.

This time last year, we discussed the risk backdrop as we headed into 2018. We highlighted the risks related to Brexit, German and Italian politics, lofty risk-asset valuations, and the removal of support from global central banks. Several of those risks reared their heads in 2018, which led to the less-than-stellar financial market results we noted above. As we head into 2019, we would like to highlight that few of 2018's risks have been resolved. In fact, we add a few new challenges to the list with the continued and escalating trade disputes between the United States and China, the widening U.S. fiscal deficit as well as the ongoing U.S. government shutdown that began last month. The risks the markets and economy face in 2019 carry more weight going forward as tightened financial conditions and weakening global growth prospects give policy makers less room for error. That said, positive outcomes in the risk backdrop also provide for potential outsized rewards given the market repricing noted in the fourth quarter. Any improvement to the increasingly fragile backdrop is likely to be cheered by markets.

Growth in the U.S. was above trend in 2018 as the economy responded to a large dose of fiscal stimulus from tax reform and increased deficit spending by the federal government. As of the end of the third quarter, real gross domestic product (GDP) in the U.S. was growing at a three percent pace. That level of growth is well ahead of the 10-year average of 1.7 percent per quarter. Heading into 2019, U.S. growth appears set to return back toward trend growth as domestic stimulus wears off combined with cooling economies overseas, notably in Europe, China, and Japan.



While U.S. economic growth looks set to cool in 2019, there is ample reason to be optimistic about the U.S. consumer's ability to keep growth in positive territory. Keep in mind, consumption accounts for approximately 70 percent of GDP in the U.S. The consumer enters the year in a rather comfortable position as new job gains continue to add up, wage growth is finally accelerating, and consumer inflation remains muted. On top of a positive income and inflation setup, the consumer balance sheet is reasonably healthy with a savings rate near six percent and a historically comfortable debt-service ratio

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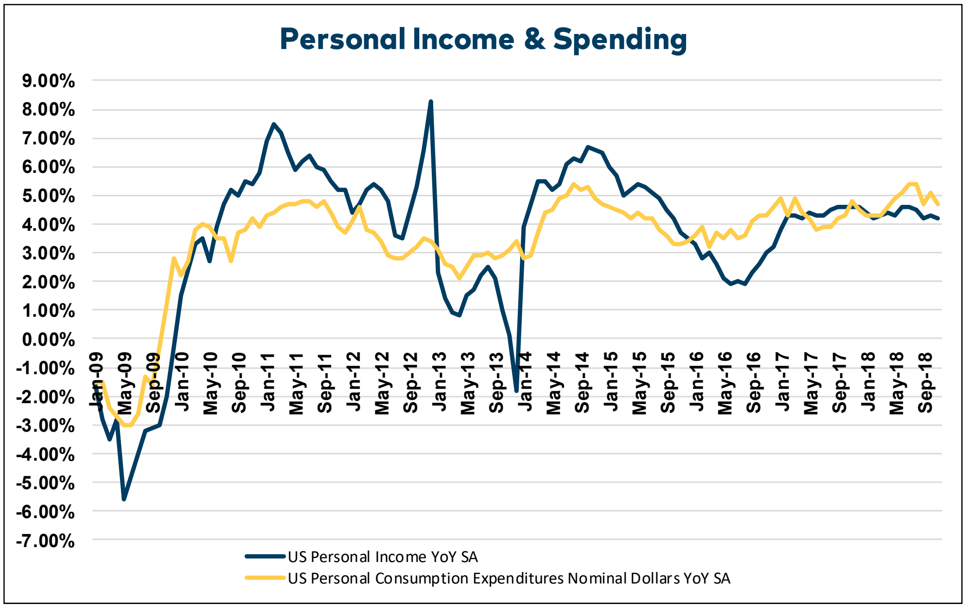
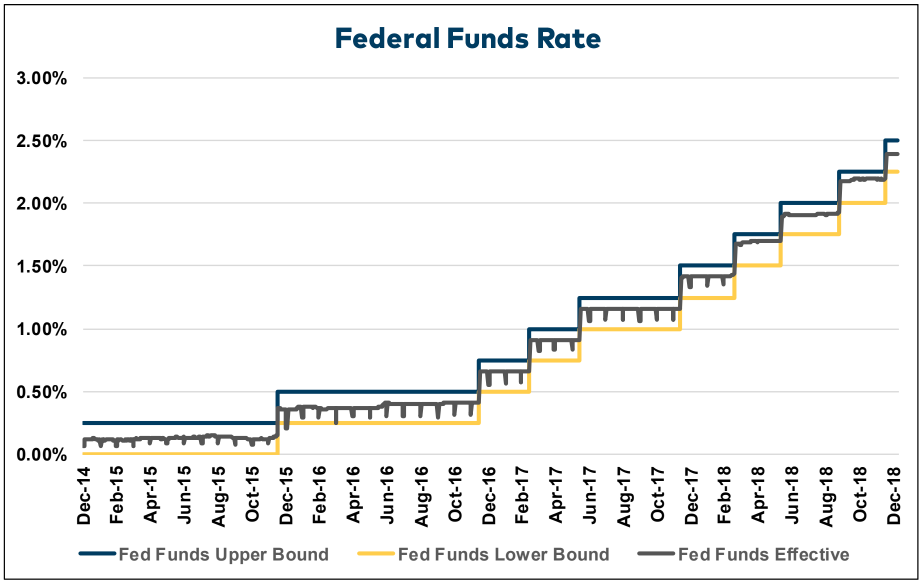
given the low level of interest rates in the past several years. As can be seen in the graph below, personal income growth is well in-line with consumption trends, signaling support for continued strong and stable consumption.



Despite several notable outcries against hiking rates for the fourth time in 2018, The Federal Reserve Open Market Committee (FOMC) moved the federal funds rate once more on December 19. The target range for the federal funds rate is now 2.25 percent to 2.50 percent. The December rate hike marks the ninth rate hike since the beginning of the current tightening cycle, which started in December 2015. At the conclusion of the meeting, the FOMC released its economic and policy projections, which indicate that the Fed is on track to hike the federal funds target rate two more times in 2019. Given the weakening economic data and rapid decline in risk assets, markets are heavily discounting the FOMC's outlook on rate hikes. As of early January, the federal funds futures market is not pricing in any further rate hikes out of the Federal Reserve.



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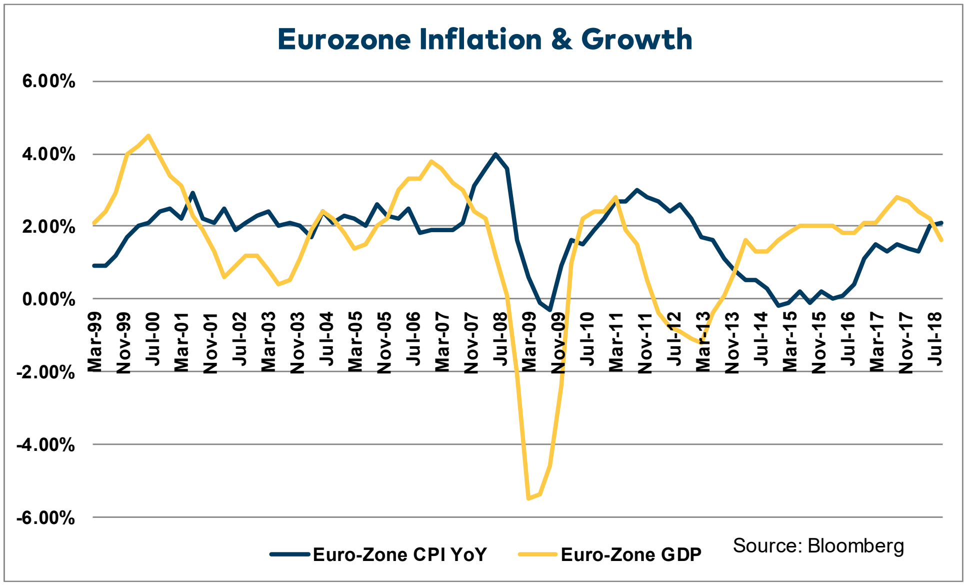
It is also timely to update readers on the actions out of the European Central Bank (ECB). The end of 2018 marks the end of the ECB's bond buying program that was put in place to stimulate economic activity by infusing money into the economy. Over the course of the last four years, the ECB purchased approximately $3 trillion worth of government and corporate bonds as part of the program. The ECB will reinvest maturities and interest payments that spin off its now $5.3 trillion balance sheet. In recent months, the ECB had been buying approximately $17 billion worth of bonds per month. Inflation and growth data, as noted in the graph below, have remained muted despite the bond buying program. Markets are not forecasting a rate hike or a reduction in the size of the ECB's balance sheet in the foreseeable future. What is notable for domestic investors is the withdrawal of bond buying from the ECB at the same time the Federal Reserve is reducing its bond holdings by $50 billion per month. This all comes at a time when the U.S. Treasury has massive funding needs to pay for the recent tax cuts and increased federal spending. The tug of war between supply and demand is unprecedented and bears monitoring for those navigating bond markets.



The confluence of weakening economic data, widespread selloff in risks assets, and the market pricing out any future Fed rate hikes has led to a reshaping of front-end interest rates. As can be seen in the graph below, and in the data table at the end of this article, the inversion is occurring in the front-end of the U.S. Treasury curve. Market participants, in an eager attempt to lock-in yields, bid up the prices on two-year and three-year Treasury securities to the point where the one-year Treasury Bill now yields more than the two-year and three-year U.S. Treasury notes. The durability of this move is something to watch. Should economic data and overhanging risks develop in a positive way, it is likely the market will shift its pricing of future fed rate hikes and correspondingly remove the inversion in the front-end of the Treasury curve. Those movements can wreak havoc in portfolios.

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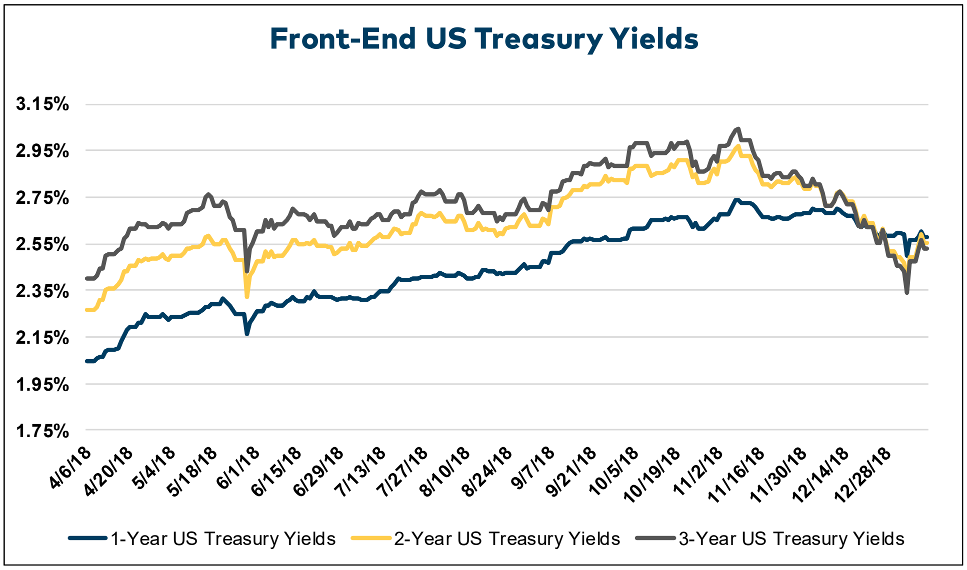
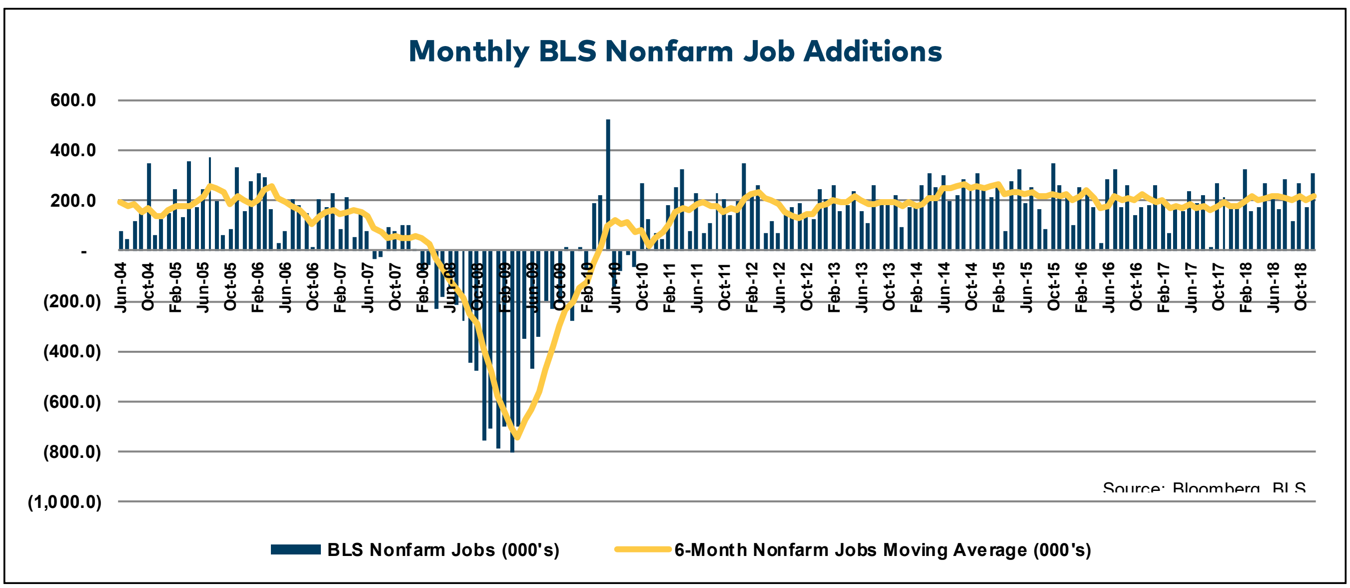


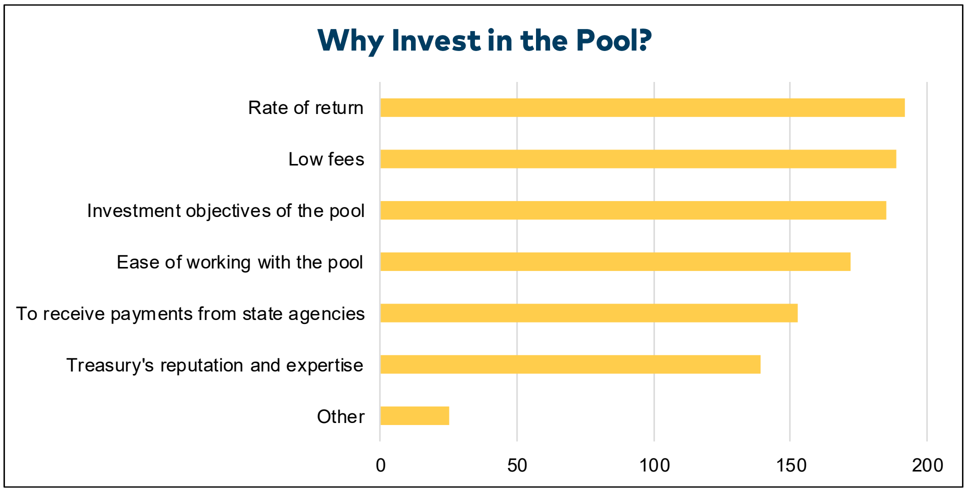
Despite the decline in stocks and downgrade in the global economic outlook, the U.S. labor market continues to add jobs at a strong pace. According to the Bureau of Labor Statistics, the economy added 762,000 nonfarm jobs during the fourth quarter. Notably, the December jobs report came in well-ahead of expectations as the economy added 312,000 non-farm jobs. In a welcome change, wage growth acceleration is finally coming to fruition as the December report printed a 3.2 percent year-over-year growth rate for wages. The unemployment rate ended the year at 3.9 percent.



Interest rates rallied into year-end as investors sought safety from risk assets. The two-year Treasury yield closed the year at 2.49 percent. Front-end corporate credit spreads, according to the Bloomberg Barclays 1-3 Year Corporate Index, ended the year at their widest level and nearly doubled during 2018. Treasury bills, LIBOR rates, and agency discount notes all remained elevated given the current federal funds target level. It is noteworthy to mention that three-month LIBOR ended the year 0.35 percent higher than the three-year U.S. Treasury yield.

LGIP Participant Survey Results

Thank you to everyone who responded to the LGIP Participant Survey. Both Treasury and PFM are excited to hear that so many of our customers find the pool easy to work with (98%) and are satisfied with our service (98.4%). And since adding online account access was a major component of 2017's transformation of the pool, we're glad to hear that our customers find EON easy to navigate (93.7%). We believe these results, coupled with the pool's rate of return and low fees, are why 27 local governments chose to join the pool last year. And while the survey shows we're on track in serving our customers' needs, we pored through your comments to see how we can do more. Throughout the year, including in this month's issue (see "LGIP Redemptions: Wire Transfer vs. ACH"), we'll provide helpful tips about how to work with the pool. And, we'll continue exploring future enhancements to meet our customers' evolving needs.



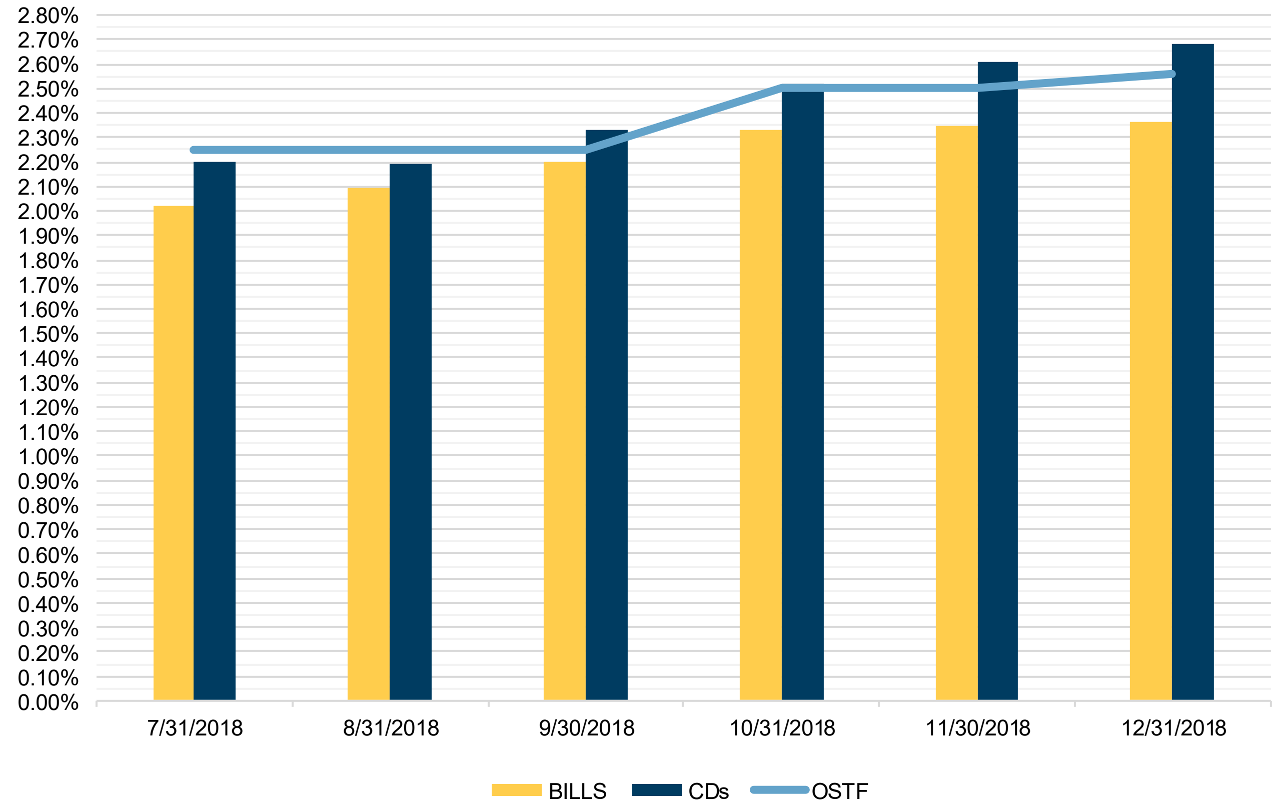
LGIP Redemptions: Wire Transfer vs. ACH

In the former Voice Response System, participants wanting to redeem (withdraw) funds from the pool chose from either same day or next day options. Behind the scenes, those options triggered either a wire transfer (for same day) or ACH (for next day). With the shift to PFM and EON, participants now have greater transparency and flexibility when redeeming funds. While redemption transactions are still processed as either a wire transfer or ACH, both types of transactions can now be scheduled up to almost a year in advance. Understanding the differences between wire transfer and ACH will help you best meet your business needs.

Wire Transfer	ACH
Can settle as soon as same day (must be initiated by 10:00 a.m.)	Can settle as soon as next business day (must be initiated by 1:00 p.m.)
Same day wire transfers cannot exceed $1.5 million (no dollar limit for future-dated wire transfer)	No dollar limit
$10.00 fee per transaction	$0.05 fee per transaction

If you need to redeem funds immediately, wire transfer is the only option available (please note that same day wire redemptions cannot exceed $1.5 million). If you do not need funds the same day, ACH may be the best option given its lower cost. Contact PFM Client Services at 855.OST.LGIP or csgwestregion@pfm.com if you have questions about which redemption option best meets your needs.

Oregon Short Term Fund Analysis



	7/31/2018	8/31/2018	9/30/2018	10/31/2018	11/30/2018	12/31/2018
LGIP AV DOLLARS INVESTED (MM)	6,778	6,959	6,886	6,602	9,377	10,030
STATE AGENCY AV DOLLARS INVESTED (MM)	11,826	11,425	11,163	10,795	10,936	10,903
TOTAL OSTF AV DOLLARS INVESTED (MM)	18,604	18,384	18,049	17,397	20,313	20,933
OST ANNUAL YIELD (ACT/ACT)	2.25	2.25	2.25	2.50	2.50	2.56
3-MO UST BILLS (BOND EQ YLD)	2.02	2.10	2.20	2.33	2.35	2.36
3-MO US CD (ACT/360)*	2.20	2.19	2.33	2.52	2.61	2.68

NOTE: The OST ANNUAL YIELD represents the average annualized yield paid to account holders during the month. Since interest accrues to accounts on a daily basis and the rate paid changes during the month, this average rate is not the exact rate earned by each account.

3-MO UST BILLS yield is the yield for the Treasury Bill Issue maturing closest to 3 months from month end. 3-MO US CD rates are obtained from Bloomberg and represent a composite of broker dealer quotes on highly rated (A1+/P1/F1+ from Standard & Poor's Ratings Services, Moody's Investors Service and Fitch Ratings respectivley) bank certificates of deposit and are quoted on a CD equivalent yield basis.

This material is available in alternative format and media upon request.

Market Data Table

	12/31/2018	1 Month	3 Months	12 Months		12/31/2018	1 Month	3 Months	12 Months
7-Day Agency Discount Note**	2.13	2.10	2.00	1.00	Bloomberg Barclays 1-3 Year Corporate YTW*	3.24	3.47	3.23	2.30
30-Day Agy Nt Disc**	2.25	2.21	2.13	1.16	Bloomberg Barclays 1-3 Year Corporate OAS*	0.86	0.79	0.49	0.47
90-Day Agy Nt Disc**	2.37	2.34	2.16	1.33	Bloomberg Barclays 1-3 Year Corporate Modified Duration*	1.85	1.89	1.93	1.88
180-Day Agy Nt Disc**	2.41	2.46	2.29	1.40					
360-Day Agy Nt Disc**	2.50	2.63	2.29	1.65	7-Day Muni VRDN Yield**	1.71	1.69	1.56	1.71
					O/N GGC Repo Yield**	2.55	2.36	2.35	2.00
30-Day Treasury Bill**	2.31	2.22	2.04	1.19					
60-Day Treasury Bill**	2.35	2.28	2.10	1.26	US 1 Year Inflation Break-Even**	(2.84)	(1.11)	1.18	0.85
90-Day Treasury Bill**	2.37	2.34	2.17	1.32	US 2 Year Inflation Break-Even**	0.66	1.22	1.81	1.56
6-Month Treasury Yield**	2.48	2.52	2.37	1.53	US 3 Year Inflation Break-Even**	1.14	1.55	1.93	1.71
1-Year Treasury Yield**	2.60	2.68	2.57	1.74					
2-Year Treasury Yield**	2.49	2.79	2.82	1.89	1-Day CP (A1/P1)**	2.35	2.16	2.14	1.46
3-Year Treasury Yield**	2.46	2.80	2.88	1.97	7-Day CP (A1/P1)**	2.68	2.20	2.17	1.49
					30-Day CP (A1/P1)**	2.63	2.28	2.27	1.57
1-Month LIBOR**	2.50	2.35	2.26	1.56					
3-Month LIBOR**	2.81	2.74	2.40	1.69	30-Day CD (A1/P1)**	2.47	2.30	2.23	1.53
6-Month LIBOR**	2.88	2.89	2.60	1.84	90-Day CD (A1/P1)**	2.73	2.67	2.37	1.68
12-Month LIBOR**	3.01	3.12	2.92	2.11	6-Month CD (A1/P1)**	2.89	2.89	2.59	1.79
Sources: *Bloomberg Index Services, **Bloomberg					1-Year CD (A1/P1)**	3.05	3.12	2.82	2.02

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