The Education Liquidity Fund

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THE EDUCATION LIQUIDITY FUND LETTER

JANUARY 2018

ECONOMY EXPANSION: NINE YEARS AND COUNTING

"As we reflect on how 2017 finished, it's hard not to be optimistic that the nine-year economic expansion will continue at a healthy pace into 2018. However, in the last few months of the year many economic indicators across both consumer and business sectors were at decade highs and it appears momentum is likely to accelerate thanks to year-end fiscal policy that will take effect in 2018.

Perhaps the biggest news of the quarter was the December passage of U.S. tax reform that will have implications for near term economic growth. But even without the tax law changes, economic growth had accelerated throughout 2017 and is likely to finish the year averaging nearly 3 percent over the last three quarters. Consumers continue to play a major role in the expansion, as retail sales accelerated and the housing and equity markets set record highs. These factors, as well as a very strong job market, have given the average consumer reason to feel confident about the future. Some consumer confidence data recently reached 15-20 year highs and discretionary savings rates are at decade lows.

The fixed income markets experienced a wide range of highs and lows during 2017, and performance depends on your perspective. For income-seeking investors, interest rates remained stubbornly low with the exception of short term rates. For total-return-oriented investors, the year was better than many expected as price returns and modest income levels supported solid overall returns for the quarter and the year.

Interest rate movements for the quarter and the year were highly maturity-dependent. Longer interest rates, as measured by the 10 year U.S. Treasury bond, rose during the fourth quarter but were range bound for much of the year. They ended at 2.41 percent, nearly right on top of where they started the year. But short term interest rates, as measured by the 2 year Treasury bond, rose throughout the year and ended at 1.89 percent after starting the year at 1.19 percent. The difference between the 10 year and 2 year Treasury rate reached low levels not seen in over a decade. We believe that this flattening of the interest rate curve will continue into 2018, but likely at a slower pace.

The largest influence on interest rates during the year was the action of the Federal Reserve (Fed), which increased short term interest rates three times in 2017 and appears poised to raise rates three times in 2018. In addition, the Fed began their balance sheet reduction program during the fourth quarter which, over multiple years, will reduce their holdings of Treasury and mortgage-backed securities owned as part of their quantitative easing (QE) purchase programs of the past.

The outlook for 2018 suggests that these trends should continue but perhaps at a slower pace. Inflation may also play a larger role in the bond markets in the coming year if economic activity continues and accelerates in 2018. While fixed income investors experienced solid returns in 2017, we believe returns will be more modest in the year ahead."

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EVENTS

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IASBO Conference

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Martin L. King Day

February 19
Presidents' Day

March 30
Good Friday

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