

Macro Update

January 9, 2018

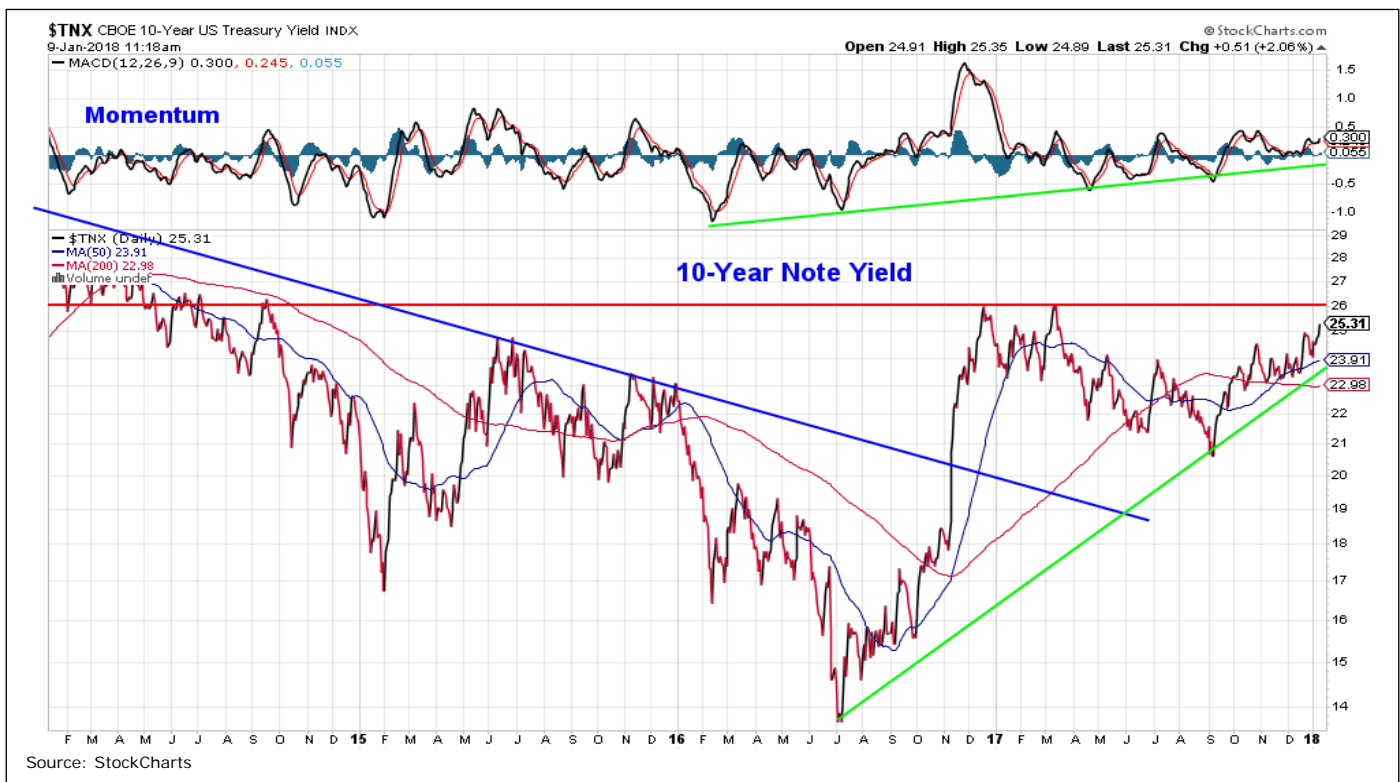
Please refer to Appendix – Important Disclosures.

Bond Yields Moving Higher As Global Economy Exceeds Expectations

Key Takeaways: The yield on the 10-Year T-Note has broken out to its highest level since March 2017. Inflation bears watching, especially with the global economy showing surprising strength. The uptick in commodity prices could contribute to higher inflation readings later this year.

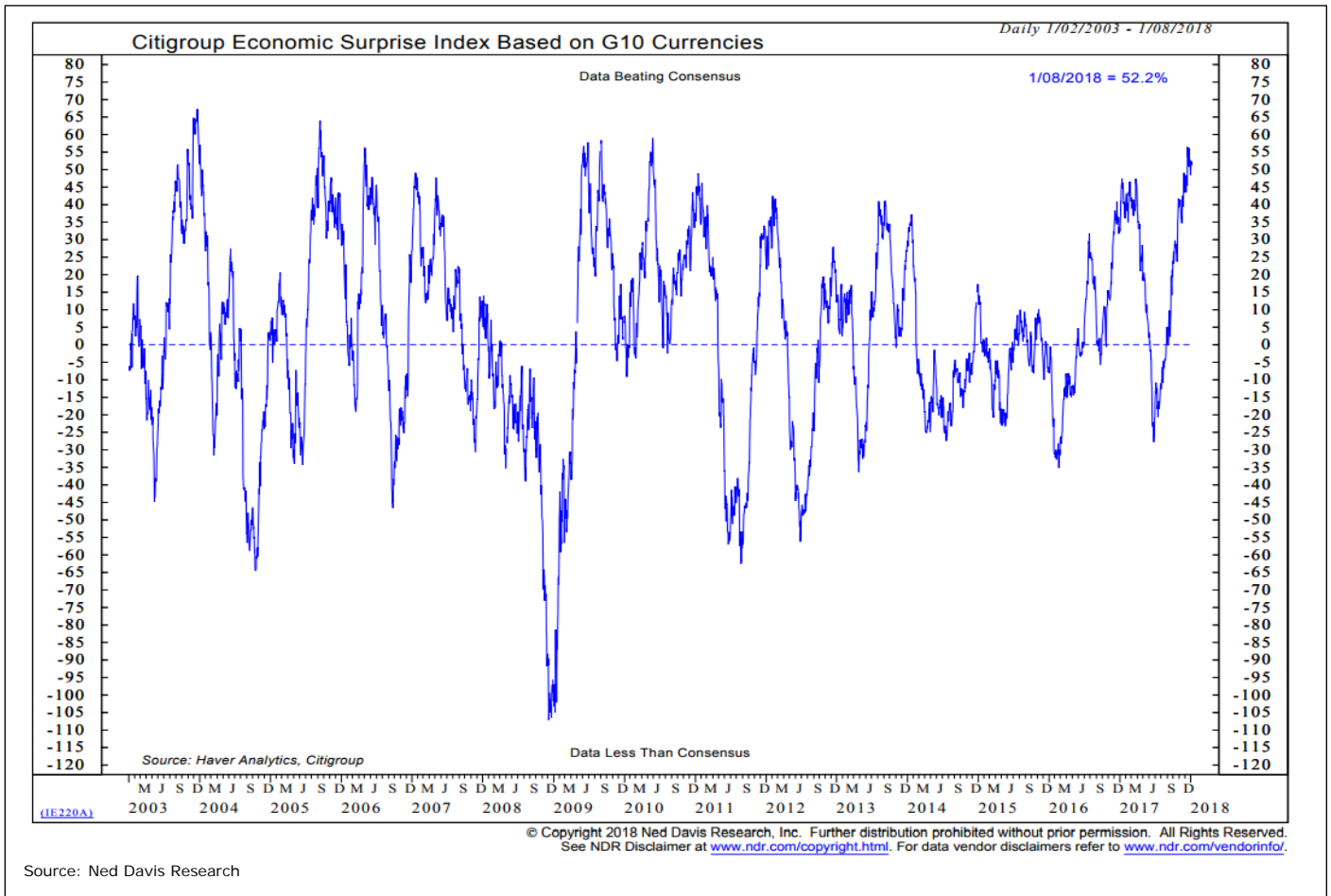
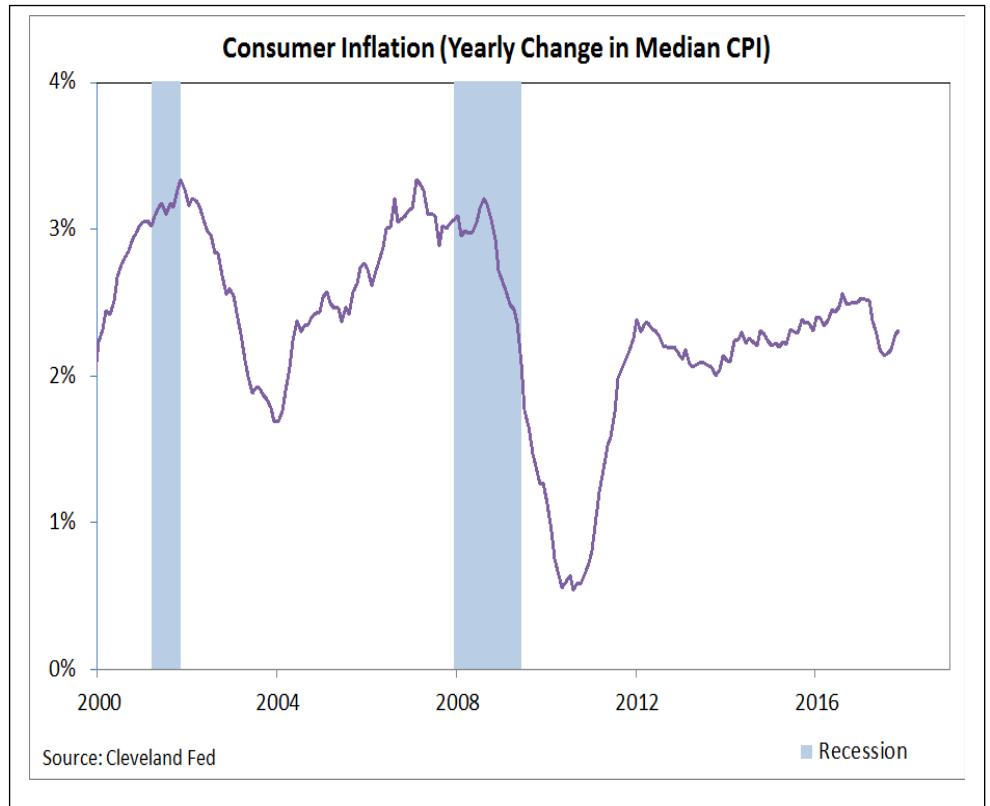
It is a discipline that has fallen out of favor of late, but it is still (theoretically at least) possible to discuss the direction of bond yields without invoking the persistence or demise of the decades-long down-trend in yields. We will have to wait until we can look through the rear-view mirror before we know whether the current rise in yields has secular significance. For now, we can make a much more modest claim – the yield on the 10-year T-Note has risen to its highest level since March of last year and with the trend in momentum moving higher, a test of the late-2016/early-2017 peak near 2.60% could be imminent.

Given the entrenched positions on either side debate over the health of the longer-term trend in bond yields, it would not be surprising to see a test of this level followed by a quick move away from it. This could mean a quick retreat back toward 2.1%, but with commodity prices perking up and the global economy showing continued strength a more likely move (from our perspective) would be toward 3.0%. This scenario becomes more likely if evidence of rising inflation becomes manifest in the data.



Inflation, by most measures, has yet to breakout to the upside. The yearly change in the Cleveland Fed's Median CPI moved higher over the second half of 2017, but remains shy of its 2016 peak. Wage growth shows a similar pattern. That could in coming months, as the New York Fed's gauge of underlying inflation pressure has broken out to the upside.

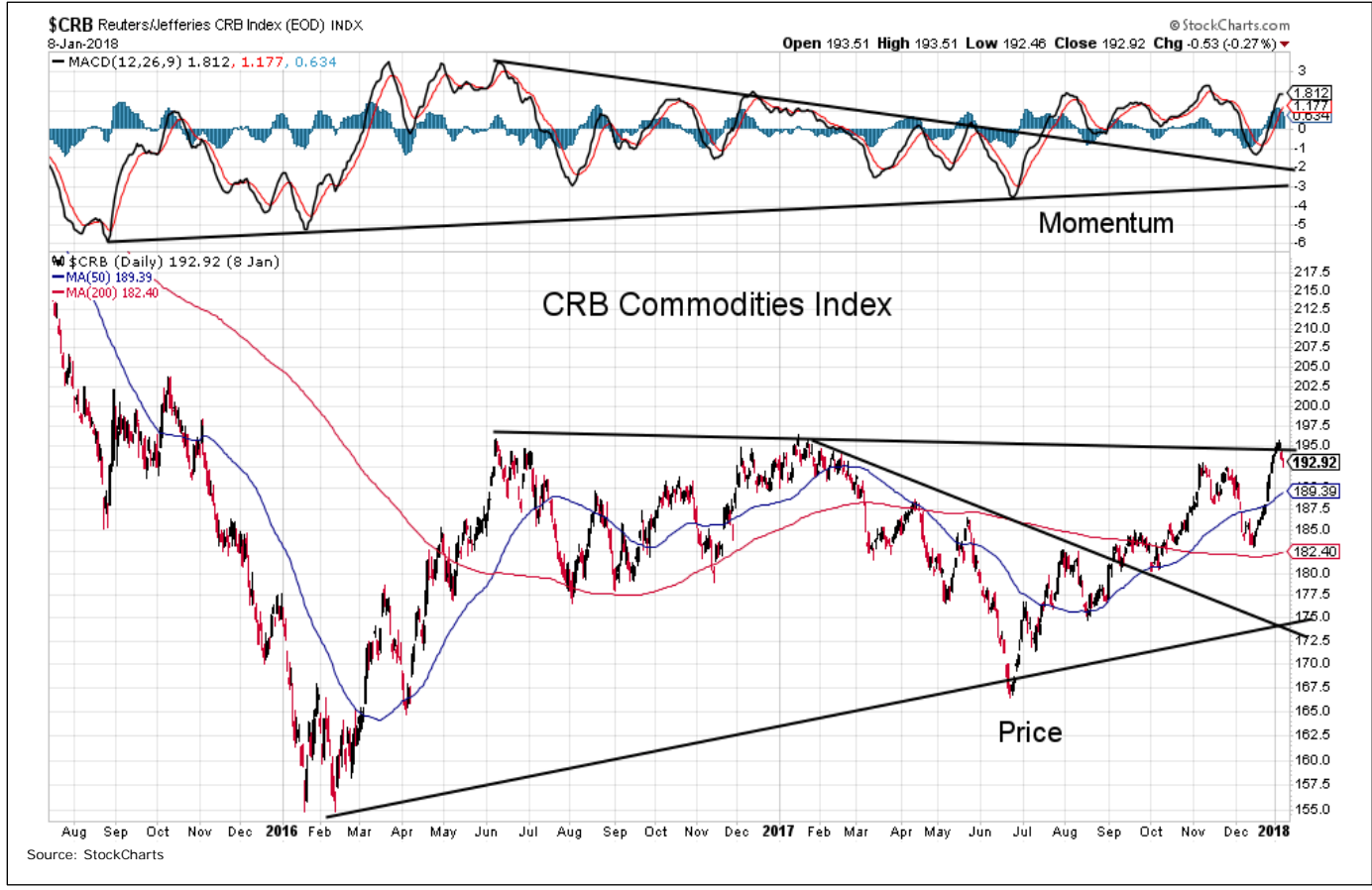
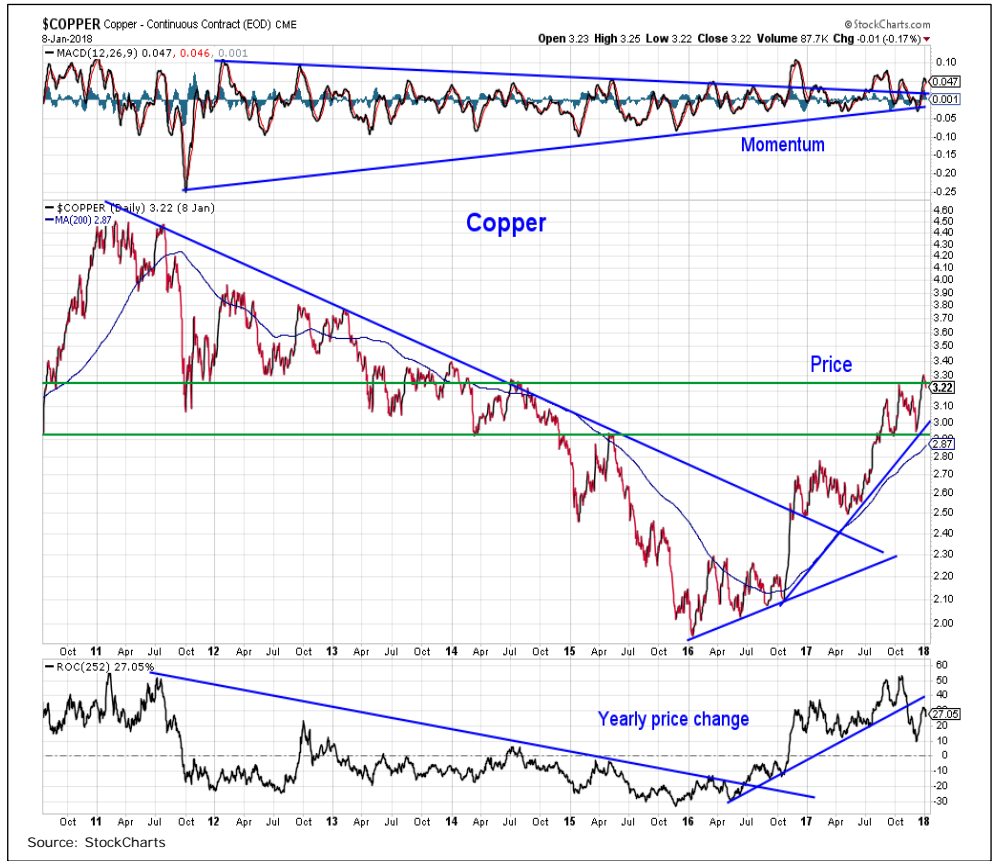
What is being seen, however, is surprising strength in the global economy. Purchasing Managers' Indexes around the world are at multi-year highs, and the Economic Surprise Index based on the G10 shows that global economy continues to fare better than expected (this surprise index is at highest level since 2010).



Source: Ned Davis Research

Better-than-expected growth is not reason alone for bond yields to move higher. Bonds traders could be keeping an eye on commodity prices as well. Copper prices led the way in 2017 signaling strength in the global economy, and the broader CRB index is now on the cusp of breaking out to its highest level since 2015.

A shift in the commodity price trend could be evidence that inflation pressures are building, with central banks around the globe easing away from quantitative easing and optimism about the prospects for the economy still elevated, it could be sufficient to put further upside pressure on bond yields.



Appendix – Important Disclosures and Analyst Certification

This is not a complete analysis of every material fact regarding any company, industry or security. The opinions expressed here reflect our judgment at this date and are subject to change. The information has been obtained from sources we consider to be reliable, but we cannot guarantee the accuracy.

ADDITIONAL INFORMATION ON COMPANIES MENTIONED HEREIN IS AVAILABLE UPON REQUEST

The Dow Jones Industrial Average, S&P 500, S&P 400 and Russell 2000 are unmanaged common stock indices used to measure and report performance of various sectors of the stock market; direct investment in indices is not available. Baird is exempt from the requirement to hold an Australian financial services license. Baird is regulated by the United States Securities and Exchange Commission, FINRA, and various other self-regulatory organizations and those laws and regulations may differ from Australian laws. This report has been prepared in accordance with the laws and regulations governing United States broker-dealers and not Australian laws.

Other Disclosures

The information and rating included in this report represent the research analyst's views based on a time horizon of 12 months, as described above, unless otherwise stated. In our standard company-specific research reports, the subject company may be designated as a "Fresh Pick", representing that the research analyst believes the company to be a high-conviction investment idea based on a subjective review of one or more fundamental or quantitative factors until an expiration date specified by the analyst but not to exceed nine months. The Fresh Pick designation and specified expiration date will be displayed in standard company-specific research reports on the company until the occurrence of the expiration date or such time as the analyst removes the Fresh Pick designation from the company in a subsequent, standard company-specific research report. The research analyst(s) named in this report may, at times and at the request of clients or their Baird representatives, provide particular investment perspectives or trading strategies based primarily on the analyst's understanding of the individual client's objectives. These perspectives or trading strategies generally are responsive to client inquiries and based on criteria the research analyst considers relevant to the client. As such, these perspectives and strategies may differ from the research analyst's views contained in this report.

Baird and/or its affiliates may provide to certain clients additional or research supplemental products or services, such as outlooks, commentaries and other detailed analyses, which focus on covered stocks, companies, industries or sectors. Not all clients who receive our standard company-specific research reports are eligible to receive these additional or supplemental products or services. Baird determines in its sole discretion the clients who will receive additional or supplemental products or services, in light of various factors including the size and scope of the client relationships. These additional or supplemental products or services may feature different analytical or research techniques and information than are contained in Baird's standard research reports. Any ratings and recommendations contained in such additional or research supplemental products are consistent with the research analyst's ratings and recommendations contained in more broadly disseminated standard research reports. Baird research analysts may provide incremental data points or views regarding covered companies in the form of Research Posts and Flash Reports. All Posts and Flash Reports are available to clients via <https://bol.rwbaird.com/Login>, but not all are sent directly to clients. Baird Associates may, at their discretion, choose whether to send these Posts and Flash Reports to Baird clients after they are posted online. Such decisions are based on, among other things, client interest, coverage, stock ownership and indicated email preferences. The incremental content and/or analysis contained in these pieces may be useful to investors as part of a broader investment thesis, but is not sufficient to warrant a change in the research analyst's published opinion, including rating, estimates and price targets. Access to <https://bol.rwbaird.com/Login> is available to all Baird Clients. Contact your Baird representative if you would like access to <https://bol.rwbaird.com/Login>.

United Kingdom (“UK”) disclosure requirements for the purpose of distributing this research into the UK and other countries for which Robert W. Baird Limited holds a MiFID passport.

The contents of this report may contain an "investment recommendation", as defined by the Market Abuse Regulation EU No 596/2014 ("MAR"). This report does not contain a "personal recommendation" or "investment advice", as defined by the Market in Financial Instruments Directive 2014/65/EU ("MiFID"). Please therefore be aware of the important disclosures outlined below. Unless otherwise stated, this report was completed and first disseminated at the date and time provided on the timestamp of the report. If you would like further information on dissemination times, please contact us. The views contained in this report: (i) do not necessarily correspond to, and may differ from, the views of Robert W. Baird Limited or any other entity within the Baird Group, in particular Robert W. Baird & Co. Incorporated; and (ii) may differ from the views of another individual of Robert W. Baird Limited.

This material is distributed in the UK and the European Economic Area (“EEA”) by Robert W. Baird Limited, which has an office at Finsbury Circus House, 15 Finsbury Circus, London EC2M 7EB and is authorized and regulated by the Financial Conduct Authority (“FCA”) in the UK.

For the purposes of the FCA requirements, this investment research report is classified as investment research and is objective. This material is only directed at and is only made available to persons in the EEA who would satisfy the criteria of being "Professional" investors under MiFID and to persons in the UK falling within Articles 19, 38, 47, and 49 of the Financial Services and Markets Act of 2000 (Financial Promotion) Order 2005 (all such persons being referred to as “relevant persons”). Accordingly, this document is intended only for persons regarded as investment professionals (or equivalent) and is not to be distributed to or passed onto any other person (such as persons who would be classified as Retail clients under MiFID).

All substantially material sources of the information contained in this report are disclosed. All sources of information in this report are reliable, but where there is any doubt as to reliability of a particular source, this is clearly indicated. There is no intention to update this report in future. Where, for any reason, an update is made, this will be made clear in writing on the research report. Such instances will be occasional only.

Please note that this report may provide views which differ from previous recommendations made by the same individual in respect of the same financial instrument or issuer in the last 12 months. Information and details regarding previous recommendations in relation to the financial instruments or issuer referred to in this report are available at <https://baird.bluematrix.com/sellside/MAR.action>.

Robert W. Baird Limited or one of its affiliates may at any time have a long or short position in the company or companies mentioned in this report. Where Robert W. Baird Limited or one of its affiliates holds a long or short position exceeding 0.5% of the total issued share capital of the issuer, this will be disclosed separately by your Robert W. Baird Limited representative upon request.

Investment involves risk. The price of securities may fluctuate and past performance is not indicative of future results. Any recommendation contained in the research report does not have regard to the specific investment objectives, financial situation and the particular needs of any individuals. You are advised to exercise caution in relation to the research report. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice.

Robert W. Baird Limited and Robert W. Baird & Co. Incorporated have in place organisational and administrative arrangements for the prevention, avoidance, and disclosure of conflicts of interest with respect to research recommendations. Robert W. Baird Limited’s Conflicts of Interest Policy, available [here](#), outlines the approach Robert W. Baird Limited takes in relation to conflicts of interest and includes detail as to its procedures in place to identify, manage and control conflicts of interest. Robert

W. Baird Limited and or one of its affiliates may be party to an agreement with the issuer that is the subject of this report relating to the provision of services of investment firms. Robert W. Baird & Co. Incorporated's policies and procedures are designed to identify and effectively manage conflicts of interest related to the preparation and content of research reports and to promote objective and reliable research that reflects the truly held opinions of research analysts. Robert W. Baird & Co. Incorporated's research analysts certify on a quarterly basis that such research reports accurately reflect their personal views.

This material is strictly confidential to the recipient and not intended for persons in jurisdictions where the distribution or publication of this research report is not permitted under the applicable laws or regulations of such jurisdiction.

Robert W. Baird Limited is exempt from the requirement to hold an Australian financial services license and is regulated by the FCA under UK laws, which may differ from Australian laws. As such, this document has not been prepared in accordance with Australian laws.

Copyright 2018 Robert W. Baird & Co. Incorporated