

Quarterly Investment Report Period Ending May 31, 2018



T E X A S
State Affordable Housing Corporation

Political Premiums

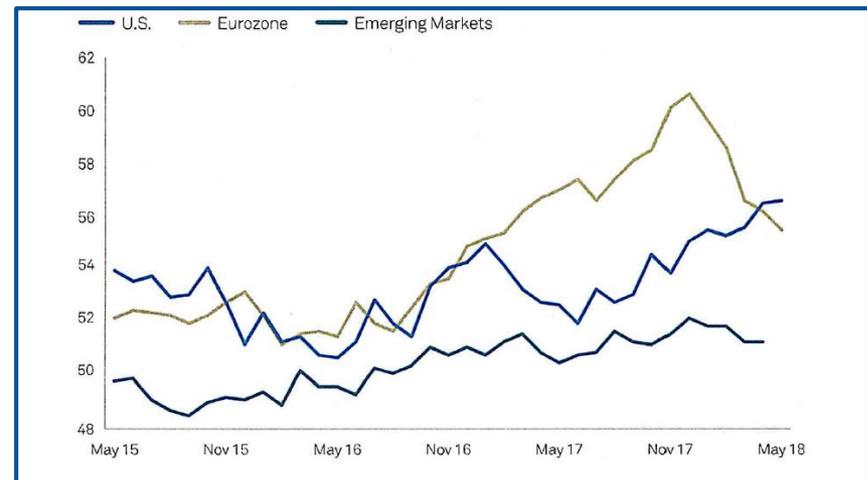
The month was dominated by political and trade events which at first created a mild headwind to the US economy and brought volatility as risks changed almost daily with those risks weighed and markets responding. Weaker EU data, heightened trade tensions and a strong US dollar were overshadowed by political uncertainty in southern Europe to add risk premiums across the globe. At month end the US and N Korea signed an agreement to establish relations for lasting peace, commitment to denuclearization and recovery of POW/MIA remains. An historic event indeed.

Trade tantrums continued and escalated through the month as the US applied tariffs unexpectedly to its closest allies (UK, Canada and the EU) and extended the steel and aluminum **tariffs** to Mexico and Canada. If the position is to apply negotiating pressure it has its dangers. NAFTA is complicated by upcoming elections in Mexico and Canada. Cross channel distortions with other trading partners may result in a backlash which could hurt the US economy and our rate trajectory. Talks with **North Korea** have been much more successful on nuclear tensions which lowers the risks which had caused a significant flight to US Treasury safety.

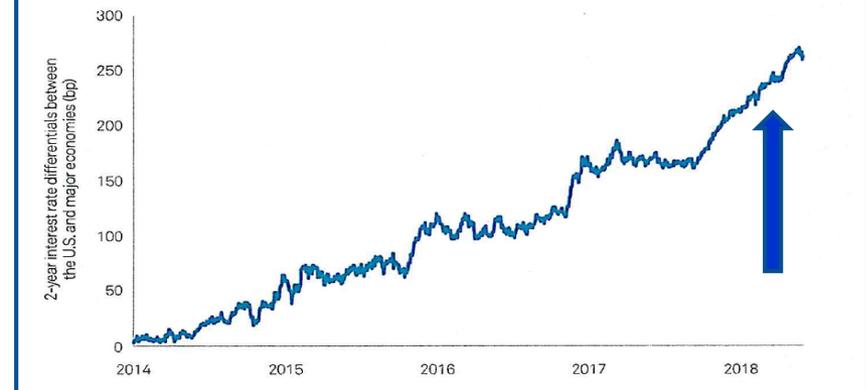
European headwinds are particularly strong as the Zone slows with low employment and inflation. The earlier EU intention to normalize rates has been put on hold and interest rates spreads to US rates make the US an attractive investment again bringing money to the US and applying downward rate pressure in the middle and long end of the curve.

The most tumultuous events however came from **Italy and Spain** both of which have new leaders. The coalition of Italian socialists created a Euro-skeptic administration supporting the fear of EU's 3rd biggest economy possible departure from the Union. Even if that does not occur it has undermined investor confidence and slowed growth in Italy. This follows a long history of Italian political turmoil but true consideration of an EU exit, toggled to Brexit and the UK problems at Ireland's border, has a distinctly more serious ring to it.

Europe Suffers from Slow Growth and Political Turmoil



INTEREST RATE DIFFERENTIALS BETWEEN THE U.S. AND MAJOR ECONOMIES



The Expansion Continues

Despite the global headwinds, the US economy continues on **its slow and steadily** improving pace.

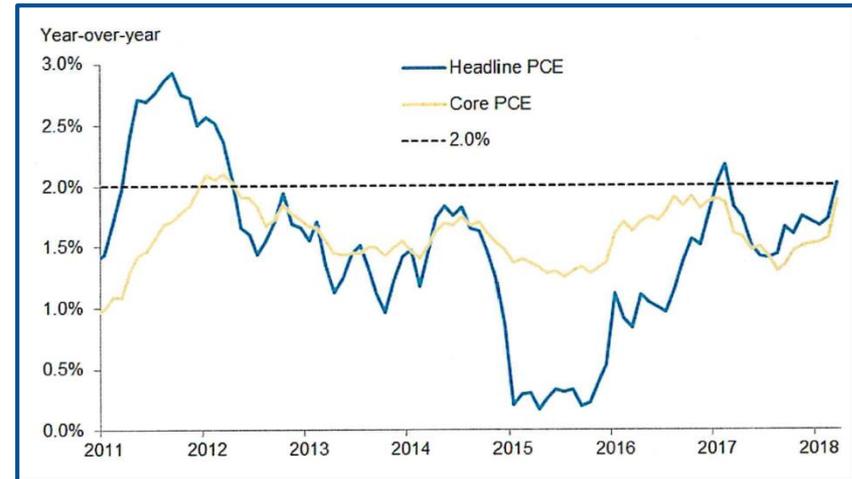
Non-farm **payrolls** in May surged past expectations adding 223,000 jobs and taking the unemployment rate to 3.8% - the lowest rate since 2000. Part of the lower rate drop was from the lower participation rate which measures folks of working age in the workforce. Otherwise the news was all positive with private payrolls and manufacturing expanding and hourly earnings accelerating. These hourly earnings put more money in consumer hands and as a result **consumer buying** has picked up after the few month's slowdown.

The **ISM** leading indicator echoed the good news across almost all its categories. Broad based gains were measured in employment, prices paid, productivity, new orders and backlogs, and supply deliveries. Matched with increasing **construction** and home sales this paints a positive picture in the US.

Inflation has also crept up slightly but remains elusive. The very strong US dollar prevents inflation growth currently but as corporations start to borrow for inventory rebuilding and capital expansion this could weaken the dollar. That weakening, of course, also helps the trade imbalance. CPI in May rose to 2.8% YOY highest since Feb 2012.

With the positive expansion the 2Q **GDP** expectations have also reached 3.1% Q/Q. This is all positive news for the FOMC meeting in June. Expectations are for a rate increase to 1.75-2% which is near what many consider the *neutral rate*: the rate at which it neither stimulates nor slows economic growth. The key here will be the rate at which they move. With negative external forces, if the FOMC moves too fast the market will expect a flat curve and could push the long end downward further. This would raise fears of a recession (often preceded by a flat curve) – a consideration well understood by the Fed.

Personal Consumption Expenditures

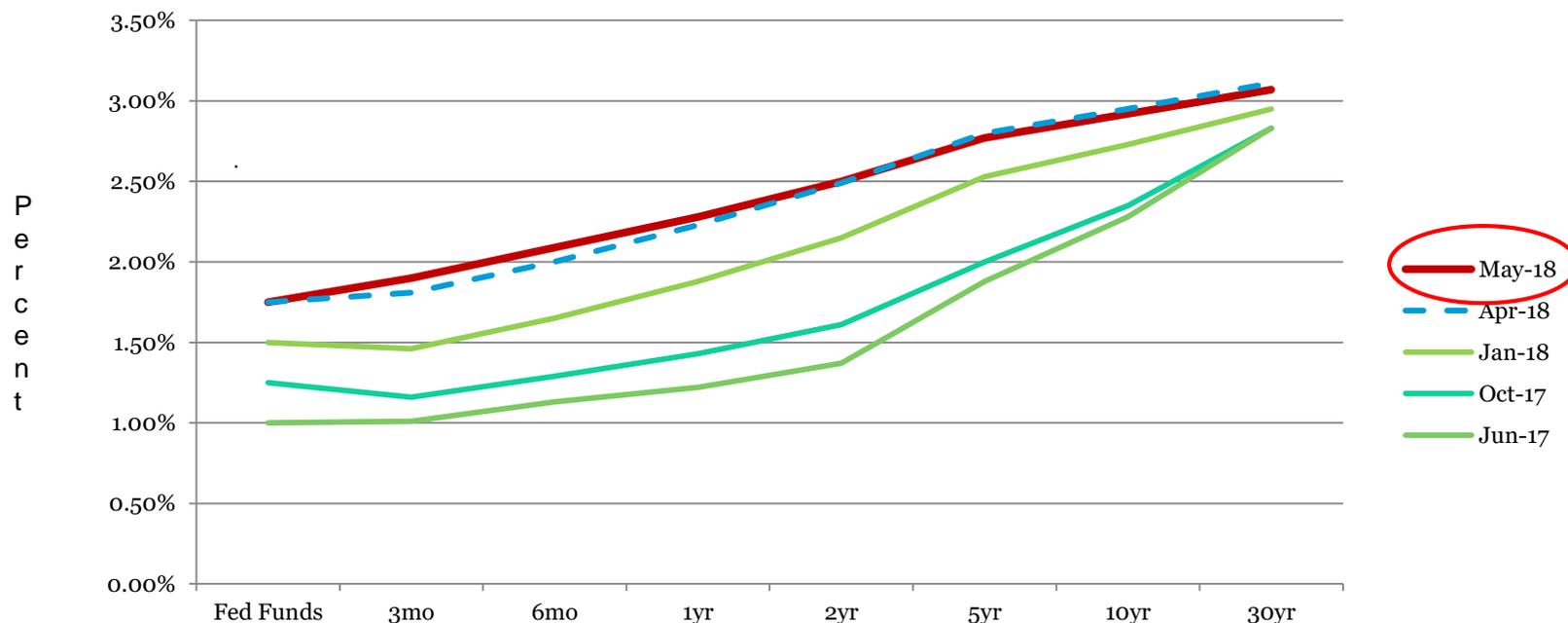


ISM Shows Strong Growth (Institute for Supply Mgmt)



Rates Struggle to Find Right Balance

- The concern for a flattening (less steep) curve has not abated and it is wait and see on the FOMC June 13th announcement. Any lessening of a hawkish tone from the Fed (to raise rates) will change the equation dramatically as the market expects at least 2 more hikes in 2018.
- Every expectation (and the futures markets) points to a rate hike in June bringing the overnight rate to the 1.75-2.0% range.
- The long end refuses to move upward until stronger indications of inflation appear. In addition, the rate differential with other sovereigns facing difficulties with slower economies continues to bring funds into the US market, even the long end.
- The yield on the Treasury 3-month is quite near the dividend yield on the S&P 500 which could cause a shift away from the riskier stock market alternatives.



End of Month Rates - Full Yield Curve – Fed Funds to 30yr

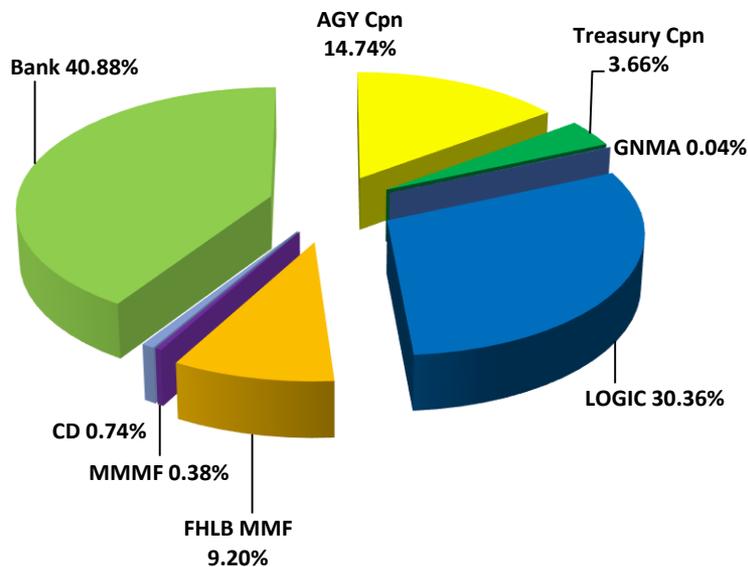
General Portfolio Overview

• Beginning Book Value	\$ 13,568,205	as of 02/28/2018
• Beginning Market Value	\$ 13,551,355	
• Unrealized Gain/Loss	\$ (16,850)	
• WAM	68 days	
• Quarterly Yield	0.905 %	
• Ending Yield	1.647 %	
• Interest Earnings for Quarter	\$ 18,830	

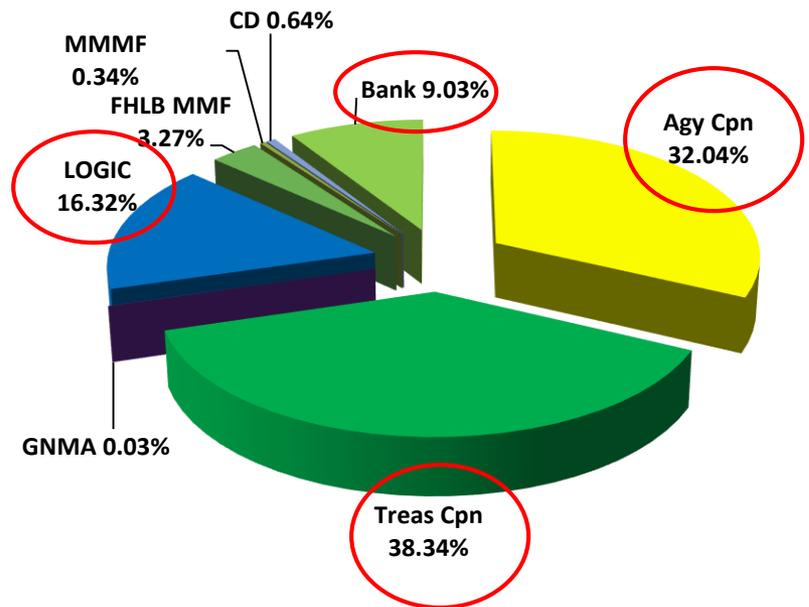
• Ending Book Value	\$ 15,606,219	as of 05/31/2018
• Ending Market Value	\$ 15,573,267	
• Unrealized Gain/Loss	\$ (32,952)	
• WAM	168 days	
• Quarterly Yield	1.683 %	
• Ending Yield	1.727 %	
• Interest Earnings for Quarter	\$ 78,268	

General Portfolio Allocations

Allocation by Market Sector 2/18

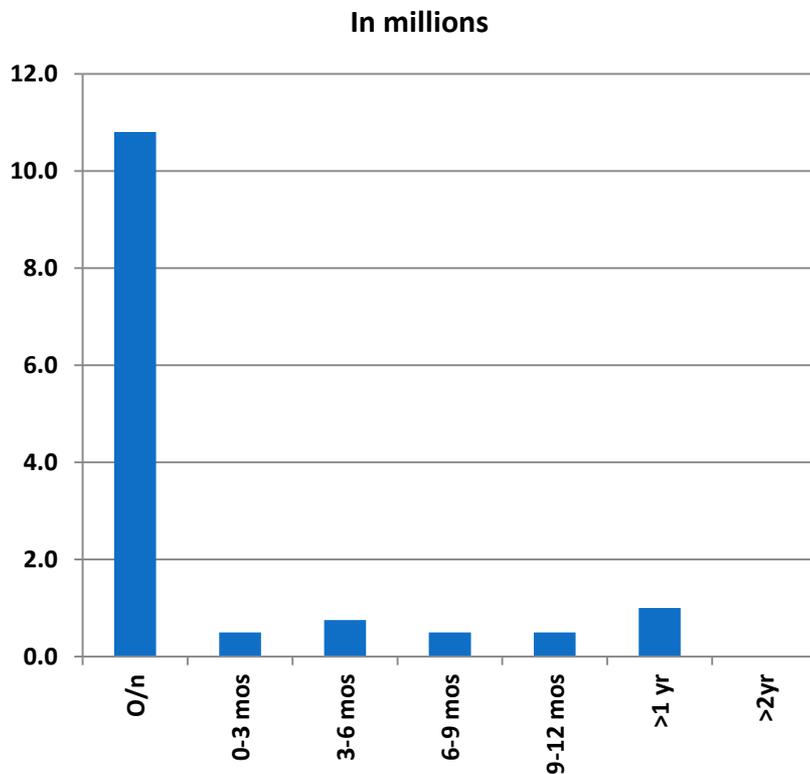


Allocation by Market Sector 5/18

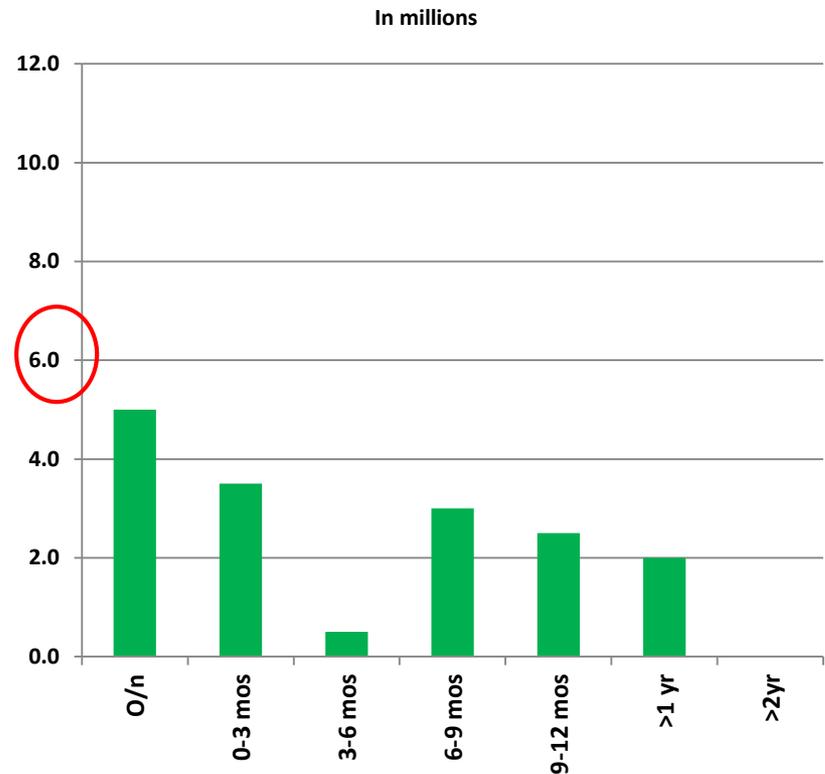


General Portfolio Maturity Allocation

Allocation by Maturity 2/18



Allocation by Maturity 5/18



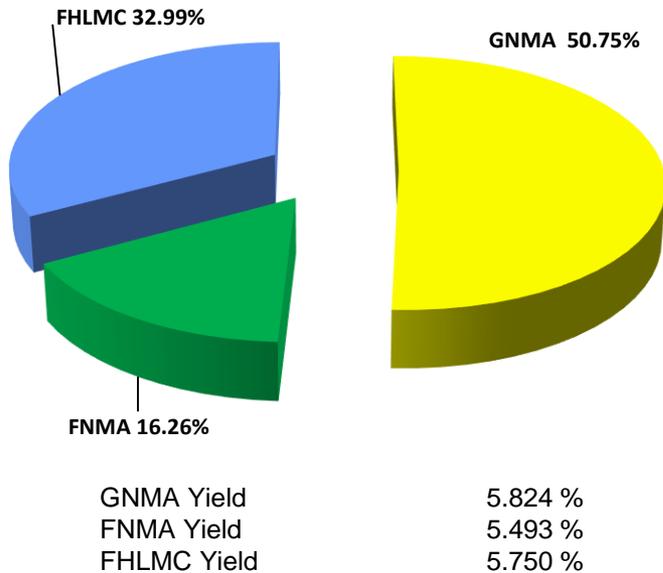
Surplus Funds Portfolio Overview

• Beginning Book Value	\$ 5,158,907	as of 02/28/2018
• Beginning Market Value	\$ 5,590,433	
• Unrealized Gain/Loss	\$ 431,526	
• WAM	7,150 days	
• Quarter Yield	5.747 %	
• Ending Yield	5.748 %	
• Interest Earnings for Quarter	\$ 75,042	

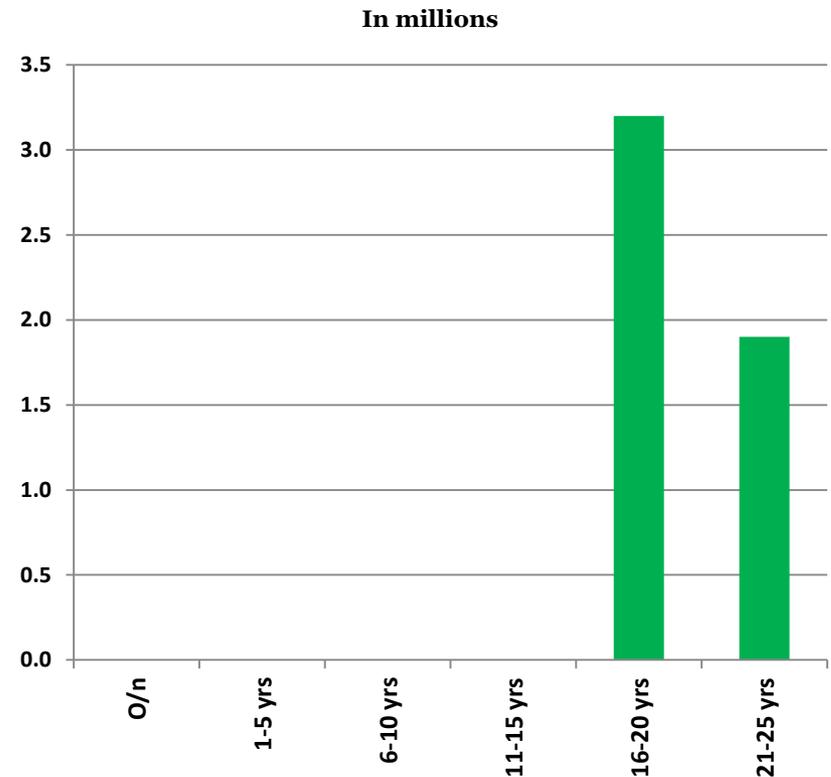
• Ending Book Value	\$ 4,938,907	as of 05/31/2018
• Ending Market Value	\$ 5,312,914	
• Unrealized Gain/Loss	\$ 374,007	
• WAM	7,119 days	
• Quarter Yield	5.750 %	
• Ending Yield	5.750 %	
• Interest Earnings for Quarter	\$ 73,254	

Surplus Funds Portfolio as of 05/31/2018

Allocation by Market Sector



Allocation by Maturity



Direct Lending Portfolio Overview

(Held Totally in bank accounts)

• Beginning Book Value	\$	116,042	as of 02/28/2018
• Beginning Market Value	\$	116,042	
• Unrealized Gain/Loss	\$	00	
• WAM		1 day	
• Quarter Yield		0.000 %	
• Ending Yield		0.000 %	
• Interest Earnings for Quarter	\$	00	

• Ending Book Value	\$	291,546	as of 05/31/2018
• Ending Market Value	\$	291,546	
• Unrealized Gain/Loss	\$	00	
• WAM		1 day	
• Quarter Yield		0.000 %	
• Ending Yield		0.000 %	
• Interest Earnings for Quarter	\$	00	

Allocation of Assets in Direct Lending





TSAHC's partner in
Treasury Management

Patterson & Associates
Austin, Texas