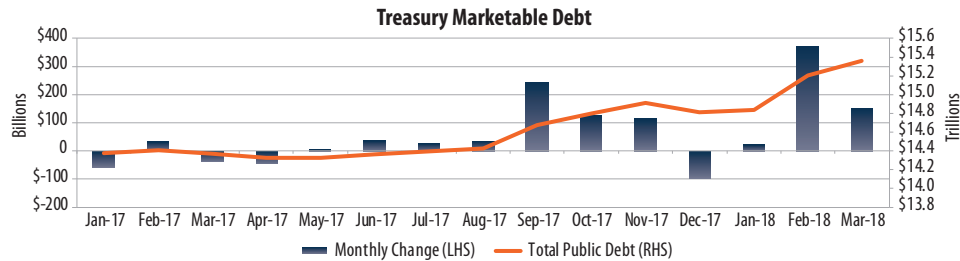


Investment Grade Viewpoint - Supply and Demand Imbalances in Front-End Markets

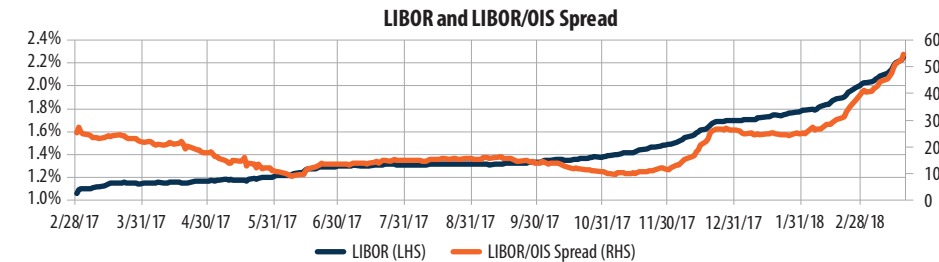
Monthly Update from the First Trust Advisors L.P. Investment Grade Team

March 2018



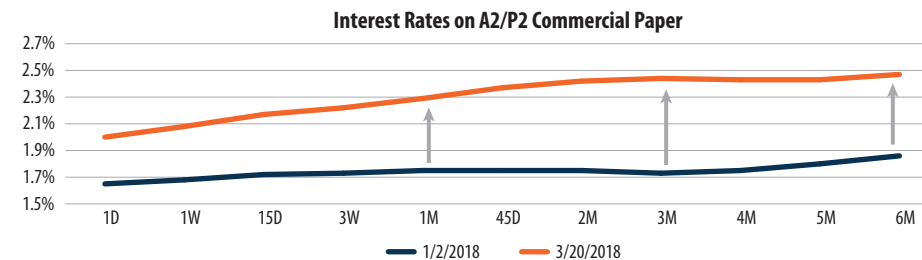
Source: U.S. Treasury, 1/31/17 through 3/15/18.

Treasury issuance is bulging to fund larger deficits and also to build up a satisfactory cash balance in the Treasury General Account of approximately \$200 billion. Constraints around the debt limit late in 2017 significantly reduced this balance. The relatively large and rapid increase in Treasury debt (\$543 billion YTD through March 15), most of it Treasury bills (T-bills), has contributed to higher yields on T-bills and other front-end instruments.



Source: Bloomberg, 2/28/17 through 3/21/18.

The new tax law incentivized repatriation of corporate cash held overseas. The sum of overseas cash held in 25 of the largest corporate liquid asset portfolios exceeded \$1 trillion as of 3Q17, according to Bank of America Merrill Lynch. These portfolios have provided significant short term funding for banks. Now, that cash is being directed toward other purposes such as dividends, share repurchases, mergers and acquisitions, and capital expenditures. The drop off in funding has contributed to the recent rise in 3-month LIBOR.



Source: Bloomberg.

At the same time Treasury issuance increased and corporate liquid asset portfolios withdrew some capital from the short term markets, banks and other corporations, increased their borrowing in the commercial paper markets. These borrowers have had to pay higher interest rates in order to satisfy funding needs. At this time, we expect higher front-end yields to persist through 2Q18 unless other investors, such as bond funds, opportunistically shift allocations and direct money toward this maturity segment.

All charts are for illustrative purposes only and not indicative of any investment. The S&P 500 Index is a capitalization-weighted index comprised of 500 stocks used to measure large-cap U.S. stock market performance. There can be no assurance that any of the cited trends will continue or forecasts will occur.

Overnight Interest Rate Swap Rate (OIS) - An interest rate swap where the periodic floating payment is based on a return calculated from the daily average compounded Federal Funds rate.

LIBOR - London Inter-Bank Offered Rate is the average of interest rates estimated by each of the leading banks in London that it would be charged were it to borrow from other banks.

LIBOR/OIS Spread - The difference between the Libor and OIS rates.

A2/P2 Commercial Paper Credit Rating - S&P and Moody's credit ratings for corporate short term lending including commercial paper. A1,2,3 is Standard & Poor's ratings tier and P1,2,3 is Moody's ratings tier.

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