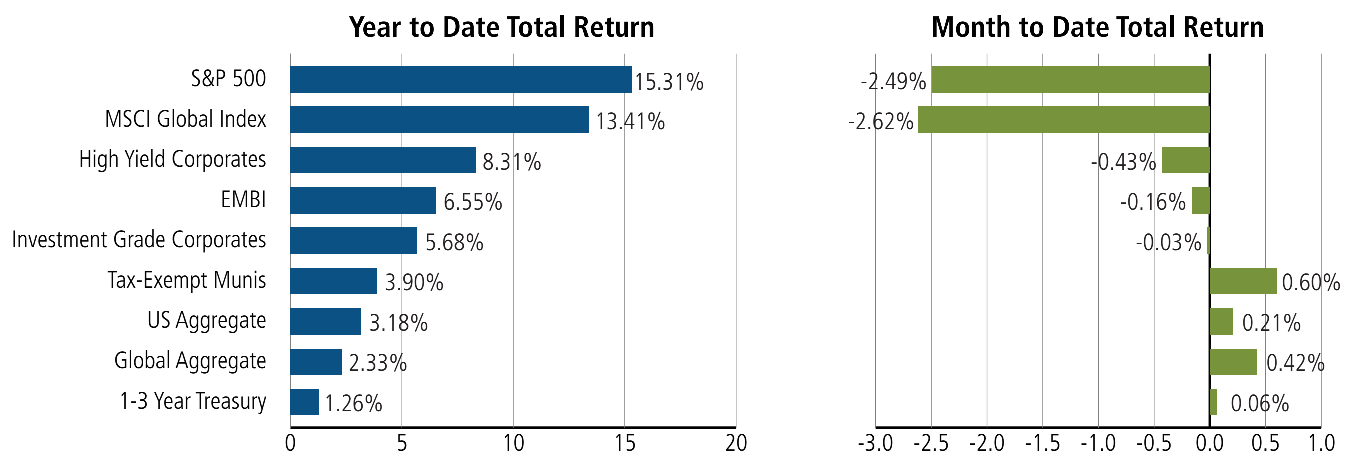
Week Ending **May 10, 2019**

Un(natural)ly Low?

Economic Overview:

In a week dominated by tweets, we took another look at the U.S. labor market. While the unemployment rate hit a cycle low of 3.6% last week, it has only been below NAIRU, an estimate of the unemployment rate that exists at full economic capacity, for 26 months. Historically, the unemployment rate falls below NAIRU before every recession since 1948. Except for one period, the official rate has remained below NAIRU for 43 months, on average, before rising as a result of a recession. If history is a guide, the labor market still has room to run. Lastly, "tight" labor market conditions have always preceded pickups in inflation, but the relationship is not perfectly linear. In one episode, low inflation in the early 1960s gave way to much higher inflation only after a long stretch of tight labor market conditions (1964-1970). Despite all the talk today about low wage growth and low inflation, could history repeat with a lag?

Total Returns by Asset Class



Highlights of the Week:

- **Corporates:** U.S. investment-grade issuance picked up in May as two of the largest U.S. corporate bond deals were priced. On Tuesday Bristol-Myers Squibb issued a $19 billion deal (11th largest ever) to partially fund its acquisition of Celgene and then the next day IBM issued a $20 billion deal (7th largest ever) to partially fund their acquisition of Red Hat. Bristol-Myers Squibb has outperformed in secondary trading while the IBM deal is wider from initial pricing.

- **Securitized Products:** While not as widely anticipated as the Uber IPO, the Commercial Real Estate Finance Council (CREFC) West conference was held this week in Santa Monica with more tempered, but realistic expectations. Underwriting remains disciplined, so commercial real estate should not be a disaster in the next downturn. That said, with low inflation and low interest rates, could asset values fall like they did in Japan?

- **High Yield:** The asset class we call "high yield" has that name for a reason – every month, across every market, the asset class generates roughly $10 billion in coupon income for its investors. This creates a natural source of demand and can boost performance in a year like 2019 when the supply of new high yield bonds is relatively low.

- **Municipal:** Municipal bond funds realized inflows for the 18th consecutive week. The year-to-date total is now up to a staggering $33.6 billion. The persistent investor demand has translated into strong performance –the broad municipal index has returned 3.90% year-to-date, while the municipal high-yield and taxable indices have returned 5.00% and 4.45%, respectively.

- **Equities:** The U.S. equity market posted its worst weekly loss since December as President Trump escalated U.S.-China trade tensions after announcing more tariffs on Chinese goods. The market was due for a breather after equity prices surged by more than 25% on very little volatility since Christmas eve. All sectors posted losses for the week with the technology and industrial sectors leading markets lower.

- **Treasuries:** Treasuries rallied across the curve this week as U.S.-China trade negotiations broke down. While negotiations might continue, tariffs have been increased from 10% to 25% and additional tariffs have been threatened but not yet registered.