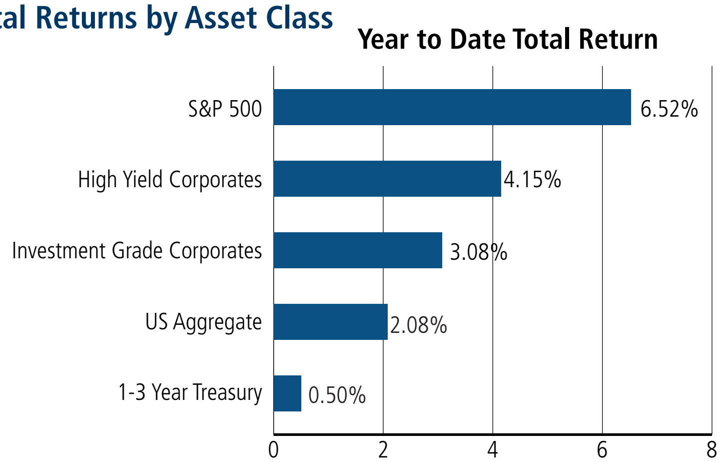
Week Ending **May 19, 2017**

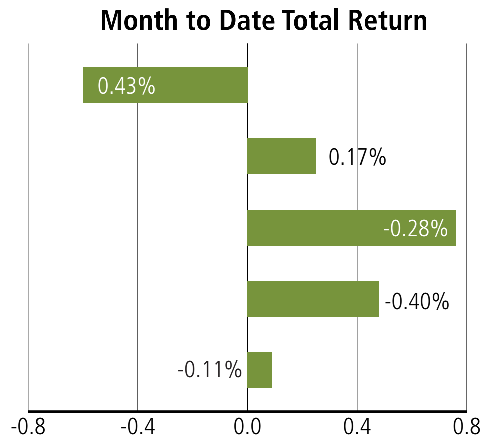
Fully Employed

Economic Overview:

Data released this week revealed that the U.K. unemployment rate ticked down to 4.6% in the three months to March 2017—the lowest rate since 1975. More importantly, the share of U.K. citizens between ages 16 and 64 with a job reached another record high, now at 74.8%. Job openings, too, hit a new high in the latest data, while layoffs flirted with their lowest levels in more than two decades. What's not to like? The Brits may have one lament: a dearth of wage growth. Average weekly pay has been bumping along at 2% in nominal terms and flat when inflation is considered. But with so few workers seeking work and so many employers hiring, could pay increases be far behind?

Total Returns by Asset Class





Highlights of the Week:

- **Treasuries:** Treasury yields gapped lower in the long end by approximately 20 (bps) basis points as political turmoil hit the boiling point in the Trump administration. The Treasury yield curve flattened significantly, with the 2/10's curve moving from 104 bps to 94, testing Q4 2016 levels. The market now expects only 1.2 hikes in 2017 and just one hike in 2018.
- **Corporates:** May has been a month of fast-paced issuance as the earnings season comes to a close. May 2016 was a record-breaking month with nearly $168 billion in new bonds. Although May 2017 may fall short of that record haul, with a week and a half until the end of the month, over $100 billion has already been issued.
- **Equities:** The U.S. equity market fell for the second consecutive week as political headwinds sent stocks to its worst daily loss of the year on Wednesday. However, the bout of increased volatility was brief with investors quickly stepping in to "buy the dip," which sent stock prices back to near record highs.
- **Emerging Markets:** In Brazil, news broke that President Michel Temer was involved in bribery pertaining to the country's far-reaching Lava Jato corruption scandal that has implicated many public officials and private citizens. Temer denied any wrongdoing, and in fact, once a potentially incriminating audio recording was released, it seemed the evidence may not be as strong as initial press reports. Brazilian assets reacted sharply the day the news was released, with the currency depreciating about 7.5% and equity markets falling roughly 10%. However, amid a lack of certainty around the consequences, both the currency and equities saw a 2.5-3% recovery the following morning.
- **Securitized Products:** The active interest at the 2nd GSE Credit Risk Transfer (CRT) conference revealed a maturing market. CRT is the program that transfers U.S. mortgage risk from taxpayers to investors. Issuers have made the structures more consistent, investors continue to expand with each new deal, and regulators have been pleased with the results. In many ways, GSE reform has been accomplished.
- **High Yield:** As fundamentals for the high yield universe have improved, the number of issuers upgraded to investment grade has been greater than the number downgraded to high yield. All things equal, this dynamic has tightened the outstanding supply of high yield bonds and should serve as a tailwind for the asset class.
- **Currencies:** Emerging market currencies normally benefit from U.S. dollar weakness but this week saw the Mexican peso, South African rand and Brazilian real lose value amid skittish market sentiment. The Brazilian currency was hit the worst after a fresh corruption scandal involving President Temer raised concerns about the country's recent progress with reforms. By Friday, the real had lost 7.75% on the week, thus erasing all of this year's gains. As the investigations continue, uncertainty about the country's political stability is likely to weigh on the real.
- **Municipals:** Yields on benchmark 10-year municipal bonds fell to post-election lows this week, as political turmoil in Washington spurred a flight to quality. Technicals remain very favorable for municipals, as the next three to four months will bring the largest cash reinvestment balances in the history of the municipal market. Net supply is expected to shrink by $40 billion June-August because of maturities and redemptions, while investors will receive $44 billion in interest payments – resulting in an $84 billion cash balance available for reinvestment. The Payden team expects strong muni performance as a result.