Payden&Rygel
Investment Management

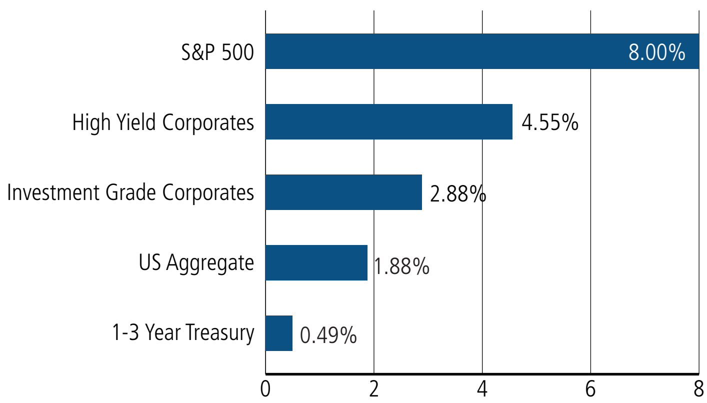
Week Ending **May 26, 2017**

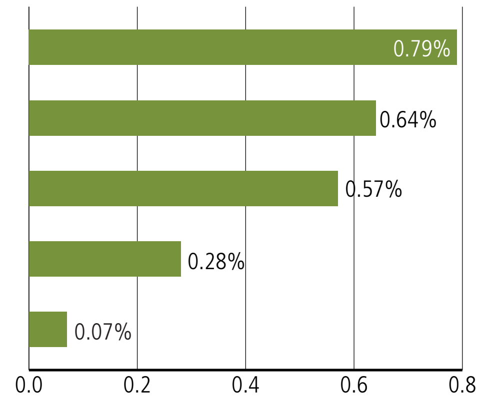
The Temperature Is Rising

Economic Overview:

We are not quite there yet, but soon we might have to call Europe what it is, "hot." A measure of the German business climate surged in May, registering a record high (114.6) for the measure dating back to 1991. Combined with other economic gauges tracked on the Continent, including consumer confidence, and purchasing managers' indices (PMIs), the euro area economy appears to be on the upswing. Politics may continue to dominate media headlines, but economic developments will be more important long-term drivers for financial markets. European prospects look better today than anytime in recent memory.

Total Returns by Asset Class





Highlights of the Week:

- **Treasuries:** Treasuries remained in tight ranges this holiday-shortened week, ending unchanged from last Friday's levels. All three auctions were strongly absorbed and traded through. The Fed minutes were interpreted as more dovish keeping curves, implied vols and yields on the lower end. Potential negative headline risks domestically and geopolitically have kept Treasuries on the defense and Fed hike probabilities muted with 1.4 hikes in 2017 and 1.1 hikes in 2018.
- **Corporates:** The attractive yield of U.S. dollar denominated investment grade corporates has kept money flowing into the market. Simultaneously, bond ETFs have become popular mechanisms for investment. With both of these momentums in tandem, investment grade corporate ETFs have grown by 16% year to date.
- **Equities:** Equities snapped a two-week losing streak with the S&P 500 breaking into record territory during a relatively quiet week. However, positive earnings from Costco and Best Buy provided relief to investors for the beaten down retail industry.
- **Emerging Markets:** Moody's lowered China's sovereign debt rating by one notch to A1 and revised the outlook to stable, from negative. Moody's attributed the change to China's increasing debt burden in the context of slower economic growth. However, it also cited China's resilience to shocks and prospects for reform as stabilizing medium-term factors. Market reaction to the news appeared limited, as the negative outlook had been in place for over a year.
- **Securitized Products:** "Biggest Subprime Auto Lender Skipped Income Verification on 92% of Auto Loans" was a popular headline this week, taking dead aim at Santander. To further fuel the fire, articles cited that competitor GM Financial income verified 64% of their most recent deal. While income verification is an underwriting factor, it is just one of many. In reality, S&P has been revising expected lifetime net cumulative loss estimates lower on Santander subprime auto ABS deals.
- **High Yield:** The PJM, which is the largest electric grid in the U.S., announced the results of its auction to secure electric generation capacity this week. The price per megawatt-day fell below consensus expectations, and the bonds of independent power producers traded off as a result. Investors should exercise caution in this highly levered sector of the high yield universe.
- **Currencies:** Emerging market currencies continued to be volatile this week. Most notable was the South African rand's recovery as the currency strengthened against the U.S. dollar by nearly 4% on the week. The rally was largely driven by rumours that President Zuma could be removed from his role due to increased pressure from the ruling African National Congress party. While many believe the exit rumours might have been exaggerated, the decreasing support for Mr Zuma is likely to help the rand stabilise in the months to come.
- **Municipals:** Municipal bond funds attracted inflows for the seventh straight week, adding approximately $394 million according to Lipper U.S. fund flows data. The shortened Memorial Day holiday week will see tempered new issuance, with only $4.8 billion expected versus a YTD weekly average of $6.4 billion. This coincides with an upcoming period of supply deficit, as the months from June to August are expected to realize net negative issuance of nearly $40 billion. The Payden team believes these technical factors will be supportive of the municipal market during the summer months.