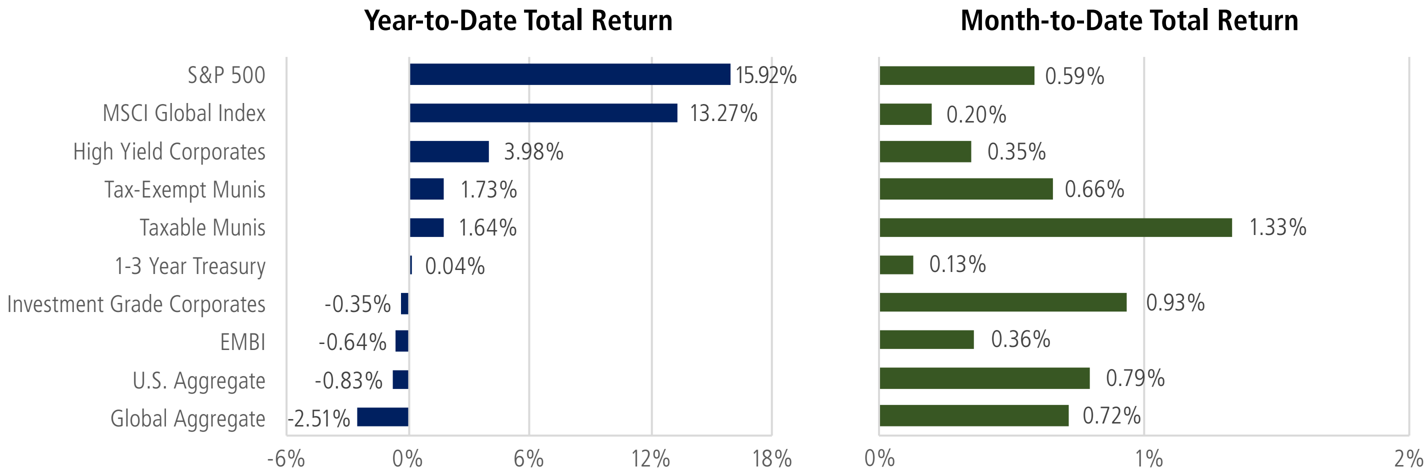
Week Ending: **July 9, 2021**

Far From Full

Economic Overview:

According to the *Employment Situation Report* released last week, 850,000 jobs were added to nonfarm payrolls in June, the biggest gain in 10 months. As a result, some investors think the Federal Open Market Committee (FOMC) is closer to tightening. We're skeptical. Recent increases in jobs were no surprise. And, as vaccinations increase, childcare and schools reopen, emergency unemployment benefits end, and immigration rebounds, we expect the trend in job growth to continue. Even so, a full labor market recovery remains far off. If job growth continues at the same rate as the past three months, we'd reach the pre-pandemic trend employment level by January 2024. Since monetary policy has been explicitly tied to "maximum employment," this chart suggests that rate hikes are still a long way off. For now, we can be both happy and hopeful. Job trends are moving in the right direction, but there is plenty of room for additional growth before investors need to worry that the central bank will take away the punchbowl.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

- **High Yield:** Companies swapping higher coupons with coupons close to all-time lows drove record refinancing activity in the high yield market during the first half of the year. This dynamic is unlikely to change in the second half of the year, which would be beneficial to high yield credit metrics. Interest coverage ratios, the ratio between earnings and interest expense, are already near all-time highs, and a continuation of this trend would cause coverage levels to increase even more.

- **Corporates:** With second quarter earnings season kicking off next week, all eyes will be on the big banks to see whether they can follow up last year's pandemic-fueled revenue binge. Trading revenues are expected to tumble 28% compared to last year. Meanwhile, loan growth is expected to fall 3% from last quarter, hurting commercial banks. However, the top U.S. banks are expected to have additional reserve releases to the tune of $8 billion.

- **Securitized Product:** The market for collateralized loan obligations (CLOs) crossed the one trillion dollar (approximately 80% U.S./20% European) threshold this week, a symbolic milestone that signals the maturing of an asset class once considered an esoteric corner of the credit world. Lately, demand for CLOs has been coming from investors seeking relatively higher yields and inflation protection in floating rate debt.

- **Municipals:** As the drought worsens, Governor Newsom is asking Californians to cut water use by 15%. Larger water systems were required to develop contingency plans after past droughts. Unlike larger water systems, smaller water municipalities lack emergency connections to other systems and will face heightened pressures given low economies of scale and limited funding resources.

- **Equities:** The U.S. equity market rallied over the holiday-shortened week to a new record high after shaking off concerns about the spread of the Delta coronavirus variant. The consumer discretionary, real estate, and tech sectors led markets higher, while the energy, financials, and materials sectors lagged the broader market.