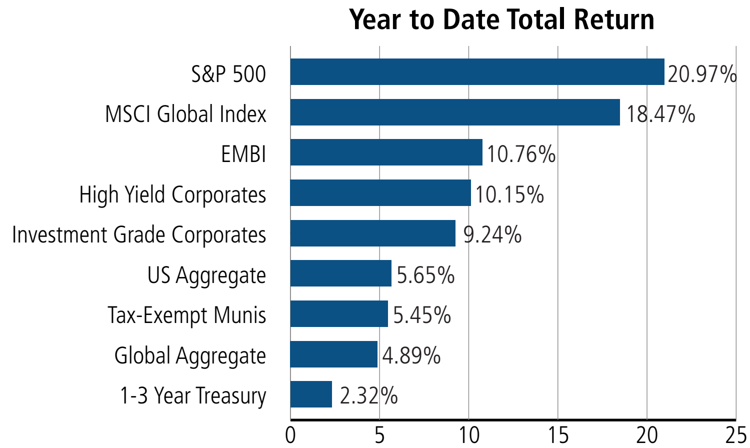
Week Ending **July 12, 2019**

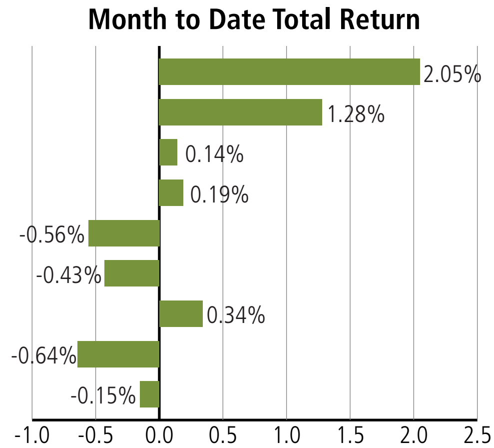
The Price Is Right

Economic Overview:

The big news this week was the green light given by the Federal Reserve for an "insurance" rate cut in July. In addition to citing the well-known trade worries, Fed Chair Jerome Powell reported another motivation: "a risk that weak inflation will be even more persistent than we currently anticipate." To the extent the Fed is cutting because of inflation concerns, we say they err. Why? Consider this week's release of the Consumer Price Index (CPI) for June. The index, excluding volatile food and energy components, rose 2.1% over the past year, and 0.3% in the past month. The monthly gain was the fastest since January 2018. However, critics might say, "the Fed targets PCE inflation." To those critics, we present the Dallas Fed's Trimmed Mean PCE metric on a three-month annualized basis. Through May 2019, inflation rose at a 2.4% annualized pace, the fastest rate in the past decade! The price, er, prices, appear right for monetary policy, and if the Fed cuts, then we must presume they are acting on other concerns.

Total Returns by Asset Class





Highlights of the Week:

- **Currencies:** This week the British pound dipped to a level last seen more than two years ago as fears of an unfavourable exit from the EU intensified and the country awaited its new Prime Minister to be elected by the Conservative Party. In addition, comments by Bank of England officials suggested an increased likelihood of a rate cut by the end of the year, particularly as the economic data weakens. Many investors believe that uncertain U.K. politics is likely to remain a drag on sterling for some time.

- **Corporates:** About a quarter of the U.S. dollar corporate universe is owned by foreign buyers. Overseas investors have been a growing buyer base during most of the last decade, but this reversed in 2018 given steep hedging costs. With rate cuts likely coming on the horizon and many Taiwanese and Japanese buyers willing to venture into U.S. dollar corporates unhedged, foreign inflows have returned and could grow further.

- **Securitized Products:** The major Canadian banks have been actively issuing USD denominated Canadian credit cards all year. For the first time this year out of Europe, Lloyds Bank (PENAR 2019-1) is issuing a dual currency UK backed credit card in both USD and GBP. Each class is 300 million with a 2-year and 3-year expected maturity, pricing at 1-month LIBOR +54 and SONIA +70 respectively. Elsewhere, expect a heavy week in ABS.

- **High Yield:** At 2.3%, global default rates remain well below the long-term average. This means that high yield bondholders are benefitting from companies' commitment to balance sheet discipline and solid operational performance.

- **Municipal:** The California state Assembly approved legislation on Thursday to create a $21 billion fund that will help utility companies cover future liabilities resulting from wildfires. The bill will also improve safety standards. California's investor-owned utility companies will be allowed to access the fund, provided they commit a combined $5 billion towards improving their electrical grids – the cost will be split evenly between the utilities and ratepayers through a 15-year extension of an existing rate increase.