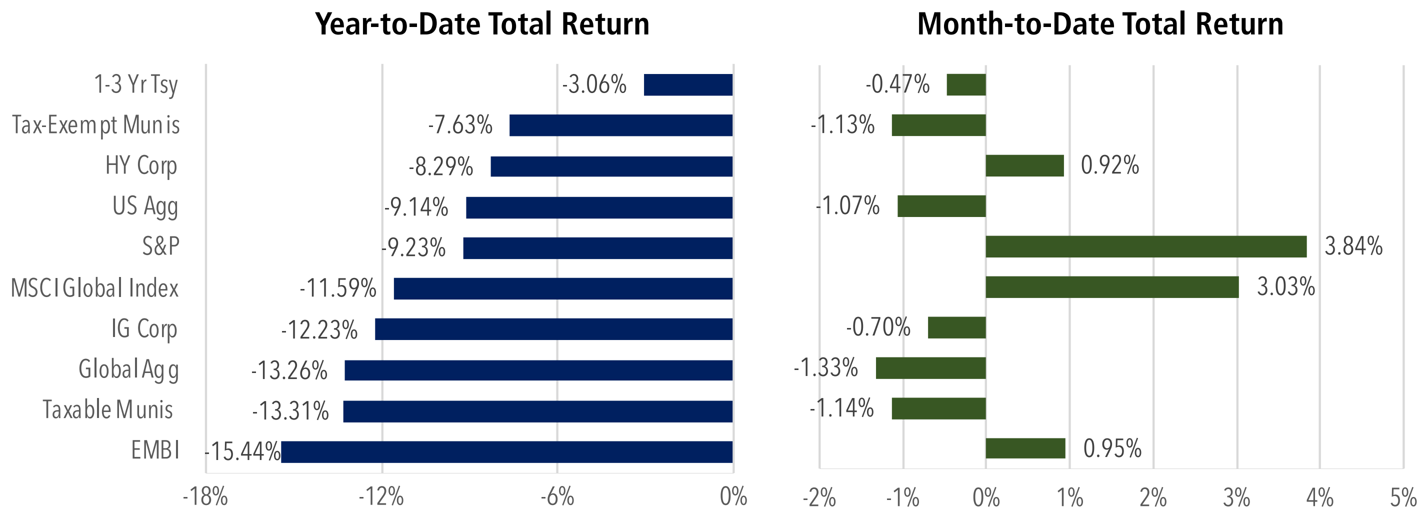
Week Ending: **August 19, 2022**

Leading The Way Down

Economic Overview:

Existing home sales tumbled to 4.81 million units (annualized) in July—a 20% year-over-year decline and the most significant one-year drop since early Covid. Although the optimists among us hope the economic weakness is contained to housing, unfortunately, the story is broader. The Conference Board's Leading Economic Index includes ten variables that track the economy's health and "anticipate turning points in the business cycle by around seven months." Unfortunately, the indicators are "flashing red" in July as the index notched a fifth consecutive monthly decline. Worse, the six-month annualized change of the index is now -3.3%, which matches the median pace of contraction in the index three months before the start of every recession since 1964. So, at the risk of being extremely unpopular at late-summer soirees (especially given the recent rebound in equity prices), it must be said that the leading indicators paint a cautionary tale.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

- **High Yield:** Stronger han expected labor market data has the market pricing in a softer landing than expected. As a result, the proportion of high yield bonds trading at distressed levels, i.e., a spread to treasuries greater than 1,000 basis points, shrank from more than 8% at the end of June to just 4% today.

- **Corporates:** The investment-grade new issue market felt alive again as the first three weeks of August saw more than $100 billion come to market, only the third time on record August has breached this mark (2022 and 2016). Deals were likely front-loaded this month as we approach the historically slow weeks leading up to Labor Day, with just $5 billion expected next week while several syndicate desks have already closed shop.

- **Securitized Products:** The increase in mortgage rates to 5% this year has led to a massive slowdown in home sales and declining home prices. Black Knight reports that San Jose's average price is 5% lower in June compared to April. Some of this decline is due to a change in the sales mix as million-dollar home sales are falling faster. Home prices tend to moderate later in the year, so we may see more price declines soon.

- **Municipals:** Municipal debt sales to fund airport projects are up 53% year-over-year, despite the broad market shrinking by 12.9%. 10-year AA-rated airport bonds currently yield approximately 64 basis points more than top-rated benchmark securities—close to the widest spread since 2020—according to Bloomberg BVAL pricing data. Payden believes airport sector bonds offer compelling value from a valuation and fundamental credit quality point of view.

- **Equities:** The equity market ended the week lower snapping a streak of four consecutive weekly gains. Light trading volumes added to the choppy trading sessions as investors continued to assess Fed policy. Consumer staples, energy, and utilities were the best performing sectors, while communication, materials, and real estate were the worst performers.