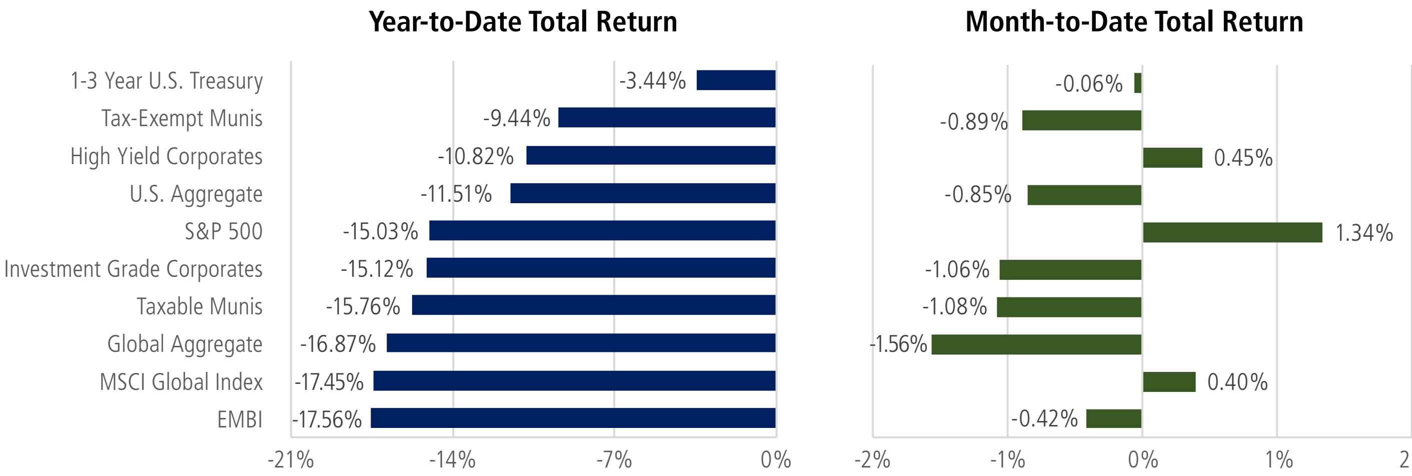
Week Ending: **September 9, 2022**

Respectfully Disagree

Economic Overview:

The Governing Council of the European Central Bank (ECB) raised its policy rates by 75 basis points this week, joining a growing chorus of central banks fighting inflation. In her post-meeting remarks, ECB President Christine Lagarde mentioned "energy" thirteen times. Why? In Europe, energy prices explain almost 40% of inflation in the last year, and, for President Lagarde, energy is the key inflation culprit. But is energy the whole story? We beg to differ. While significant, price pressures in the euro area extend well beyond energy. Excluding food and energy prices, core services contributed more than twice as much as they did over the 20-year average, while core goods contributed almost five times as much! Certainly, core goods and services may have become "infected" by high energy costs. Still, we've moved beyond ignoring energy due to month-to-month volatility as there is more breadth in euro area inflation than policymakers (and many investors) care to admit. As a result, more surprises—and jumbo rate hikes—could lie ahead.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

High Yield: Bausch's unsecured debt fell to CCC in August as the issuer's capital structure fell deeper into distress. The cause isn't a sector-wide wave of defaults such as what the market saw in 2015 with energy or in 2002 with telecoms, but problems particular to Bausch and their business. Given strong fundamentals across high yield, distress and defaults will likely continue to be driven by idiosyncratic issues.

Corporates: Investment grade corporate new issue supply came in strong with $53 billion pricing on the week, of which $35.4 billion was issued in a single day – the 7th busiest day on record and the busiest since March 2020. On average, deals saw strong books which allowed issuers to pay little concessions. Despite this, most deals are trading tighter on the week. The heavy new issue supply is expected to continue next week with expectations of up to $40 billion as issuers look to seek funding ahead of the Fed's expected rate hike later this month.

Securitized Products: European Collateralised Loan Obligations (CLOs) saw stabilisation last month, though levels seem wide relative to historical values, as Europe remains enshrouded amidst a volatile macroeconomic backdrop. Investor focus has shifted towards the impact of persistently high inflation and energy prices on the underlying leverage loan universe, with rating agencies expecting default rates to pick up towards 3% by end of 2023. However, fundamentals and structural protections on the CLO's still continue to be robust.

Municipals: Despite four straight weeks of mutual fund outflows, the State of California had no troubles issuing $2.3 billion in tax-exempt debt this week, receiving over $8 billion in orders with heavy interest from retail taxpayers. The longest maturity was issued with a yield of 4.3%, equivalent to a taxable yield of 9.4% for a California individual in the top tax bracket.

Equities: After three consecutive negative weeks, the U.S. equity market rebounded, with cyclical areas of the market leading. The best performing sectors were consumer discretionary, materials and financials, while real estate, consumer staples and energy lagged.