Week Ending **January 13, 2017**

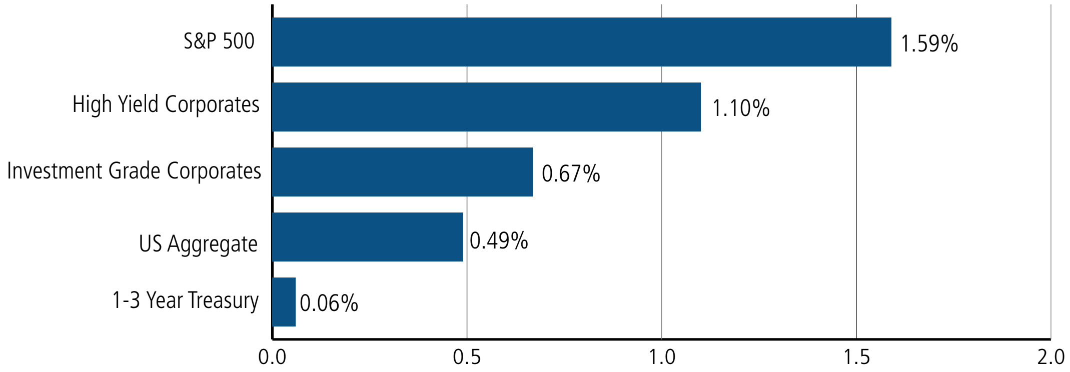
"Don" of a New Era?

Economic Overview:

An index of US business optimism compiled by the National Federation of Independent Business (NFIB) skyrocketed in December. The index's one-month increase was the best since 1980. As a result, small business optimism is at its highest level since 2004—a sign that John Maynard Keynes's famous "animal spirits" may once again stir in the hearts of American business owners. The index hovered in depressed territory for much of the last decade. Whether good feelings translate into a real increase in capital spending and hiring remains to be seen—much depends on the mix of fiscal and regulatory changes put forth by the incoming administration. Historically, business profits tell us more about future capital expenditure than sentiment alone. If profits pick up, investment should follow.

Total Returns by Asset Class

2017 Year to Date Total Return



Highlights of the Week:

- **Treasuries:** Treasury markets rallied 10 basis points (bps) during the week while digesting $56 billion in new supply from 3, 10 and 30-year auctions. Positioning drove the participation with large shorts concentrated in the belly of the curve causing the 10-year re-open auction to come two bps through 10 am levels with highest indirect participation on record. The rally was also fueled by the lack of detail in President-elect Trump's news conference on Wednesday, reversing some of the post-election euphoria. However, yields closed out the week close to unchanged from prior week due to strong than expected whisper number on the retail sales control group. Rate hike probabilities remain stable at 37% for March and 71% for June.
- **Equities:** Equities ended the week unchanged, which masked large intra-day price swings. President-elect Trump's industry specific rhetoric has weighed on market sentiment. However, a strong start to the 4th quarter earnings season, primarily from the banking sector, pulled broad equities back into the positive territory for the week.
- **Corporates:** Did Volkswagen start a bad trend? Multiple car companies came under fire this week for suspected cheating emissions systems, just like their deceptive forbearer. On Thursday, the E.P.A. accused Fiat Chrysler of installing secret software in 100,000 diesel cars. The very next day, news emerged that French prosecutors were investigating Renault for similarly flawed diesel systems.
- **Securitized Products:** In a somewhat surprising move the FHA elected to drop the amount of mortgage insurance that borrowers pay when taking out a GNMA program securitized loan. The 25 basis point drop in mortgage premium increases the ability to refinance for current GNMA borrowers. Higher coupon GNMA mortgage pools dropped in value due to their increased prepayment risk.
- **High Yield:** High Yield held up better than equities this week as investors reconsidered the likelihood that the incoming Trump administration could execute on a range of campaign promises, from ACA-repeal to corporate tax reform, in 2017. High yield should continue to provide a measure of downside protection while generating attractive carry in the 5% context.
- **Emerging Markets:** Emerging market sovereigns began to return to international markets. Ecuador issued $1 billion in 10-year bonds at 9.125%, the second time the country has issued internationally since December 2016. Additionally, both Honduras and Korea issued a 10-year bond this week, at 6.25% and 2.9%, respectively.
- **Currencies:** While most G10 currencies benefited from the recent US dollar weakness, the British pound was the exception this week. Comments by Prime Minister May on the weekend highlighted once again the uncertainty over the terms of the UK exit deal with the European Union (EU). Sterling investors shrugged off the better than expected economic data and focused on the increased likelihood of prolonged and hostile negotiations with the EU. As a result, sterling hit a fresh nine-week low against the euro.
- **Municipals:** Municipal funds registered net inflows this week, reversing a trend of eight consecutive weeks of outflows dating back to the Presidential election. Municipal ratios have tightened dramatically across the yield curve, with all key-rate ratios now below 100%. The market marched higher again this week, with new issues oversubscribed for and the secondary market benefiting from robust demand.