

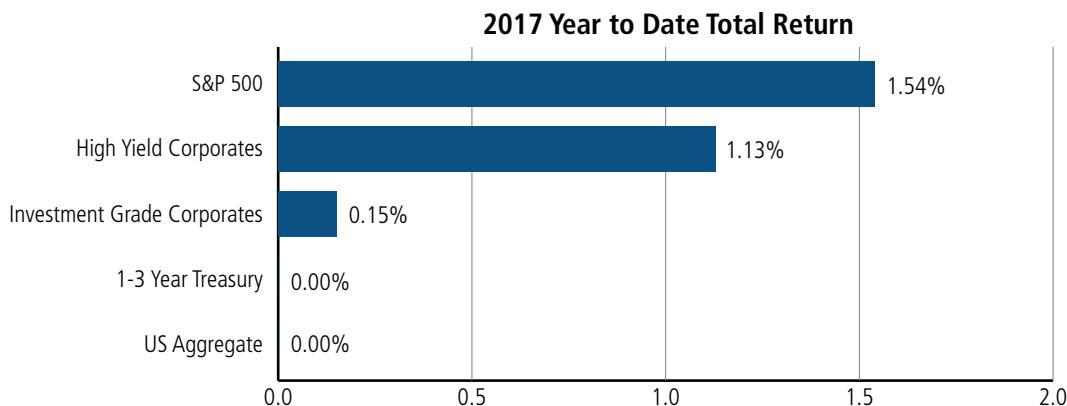
Week Ending January 20, 2017

Inflated Optimism?

Economic Overview:

From 2011 to 2015, the world inflation rate fell year after year. By 2016, the world was abuzz with deflation mania, fearing a further decline in the rate of inflation. Instead, as commodity prices recovered and global growth found its footing, consumer prices perked up in 2016. For 2017, there is a reason to believe the deflation fear may be behind us, as updated forecasts released by the International Monetary Fund (IMF) this week show [an expected annual pick-up in prices](#) for the second time in the last five years.

Total Returns by Asset Class



Highlights of the Week:

- **Treasuries:** Treasury markets absorbed stronger inflation and housing data this week. Yields ground higher every day in this holiday-shortened week. The icing on the cake was Yellen's speech on Wednesday where no one anticipated any remarks with regards to monetary policy and received hawkish ones at that. Yields backed up from the belly and out 10-15 basis (bps) with the 5/30's curve originally flattening five bps to test the lows of Aug 2016. Curves steepened back out some on Friday as the world awaited the inauguration of Donald Trump. Markets are now pricing in higher probabilities for a March and June rate hike, of 38% and 70% respectively.
- **Equities:** Equities ended another week relatively unchanged as investors awaited the inauguration of Donald Trump as the 45th U.S. President. It was a full week of corporate earnings. Thirty-four companies in the S&P 500 reported quarterly results. About 75% of companies beat analyst estimates; some notable positive surprises include Procter & Gamble, Netflix, and Union Pacific.
- **Corporates:** Earlier this week, British American Tobacco reached an agreement to buy Reynolds American as they seek more exposure in the U.S. tobacco market. The new conglomerate will form the largest tobacco company in the world (assuming the deal passes all hurdles) as tobacco companies converge and fewer players dominate the space.
- **Securitized Products:** The new issue market is finally getting started for 2017 with the first Credit Risk Transfer deal in six weeks, Fannie Mae's Connecticut Ave Securities (CAS 2017-C01). The ABS market is following along with Ford auto receivables bringing a fully compliant ABS deal both regarding the 5% risk retention requirement and full loan level disclosure. The queue for next week is also full of issuers ready to hit the marketplace.
- **High Yield:** High yield spreads are closing in on their 2014 tights. However, 2017 is not 2014, and the quality of the high yield universe has improved (for example, 49% of the universe is BB-rated compared to 46% back then). In this environment, the market has room to compress further, particularly given low expected default rates. Prudent, valuation-conscious investors should be rewarded.
- **Emerging Markets:** The latest activity data from China was a reminder of the country's adjustment from investment-led to consumption-driven growth. December industrial production and fixed asset investment growth eased modestly to 6.0% year-over-year (y/y) and 8.1% y/y, respectively, while retail sales came better than expected at 10.9% y/y. For the fourth quarter, GDP expanded 6.8% y/y, marginally ahead of the 6.7% consensus expectation.
- **Currencies:** The Canadian dollar started the year on a strong note supported by rising oil prices and the prospect of favourable trade policies under the Trump administration. However, dovish comments by Bank of Canada's Governor Poloz on Wednesday were enough to derail the loonie from its recent winning streak. The prospect of a rate cut together with lower than expected retail and CPI numbers weighed on the Canadian dollar this week, resulting in it wiping out most of its 2017 gain.
- **Municipals:** Municipal bond funds experienced a second consecutive week of inflows, taking in an additional \$511.74 million. Investor demand has been strong, with \$10 billion in new issuance well received and broad follow-through in secondary trading.