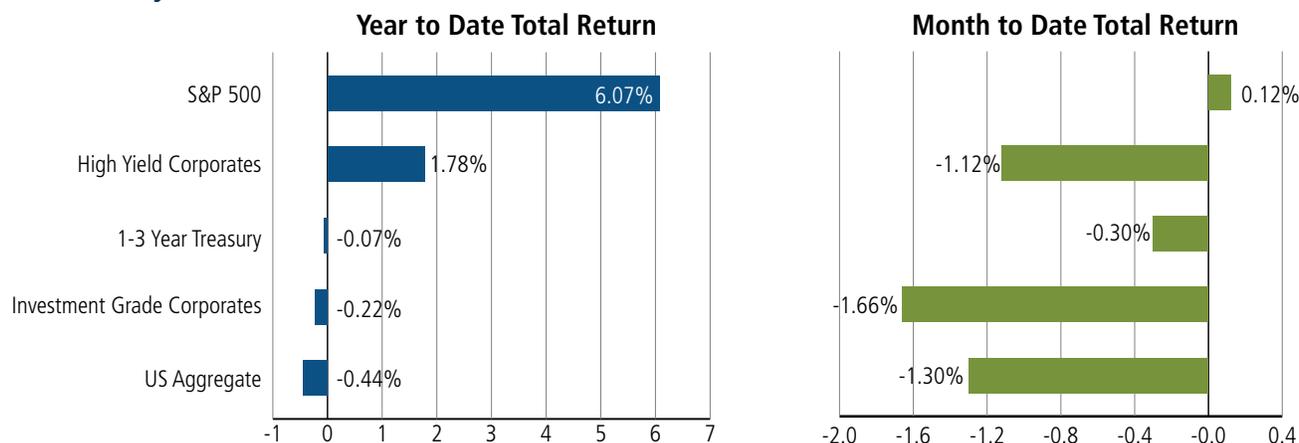


Week Ending March 10, 2017

**“Follow Me,” Bond Market Says to Fed****Economic Overview:**

[In the months before the two most recent Fed hikes, the market front-ran the Fed.](#) Whether by superior insight, fear, or obeisance to the Fed’s incessant jawboning, money market rates jumped roughly one and a half months before the Fed acted. Will this time be any different? In the past few weeks Fed officials have signaled clearly to the market an intent to raise their policy rate once again at the March 14-15 FOMC meeting. As anyone might expect, money market rates promptly jumped higher. The 3-Month Treasury bill hit 0.74% this week, its highest level since October 2008. Should investors be worried? We don’t think so. The U.S. economy can handle higher rates.

**Total Returns by Asset Class****Highlights of the Week:**

- **Treasuries:** Treasury markets were pretty quiet all week waiting for Friday’s nonfarm payroll number for better guidance on Fed hikes. The market easily absorbed this week’s Treasury auctions. The employment report was quite good with a strong 235k headline number, strong average hourly earnings (2.8% year-over-year) and a better labor force participation rate (63%). March FOMC is now 100% priced for a hike next Wednesday with 2.7 hikes priced in 2017 and 2.2 hikes in 2018.
- **Equities:** The U.S. equity market fell for the first time in seven weeks on macro concerns surrounding falling oil prices and the Fed rate hikes. Despite a weaker tone to investor sentiment, the resiliency of the stock market continued to perforate through as the broad equity market (S&P 500) has now gone through 102 trading sessions without a 1% decline, which is the longest streak in more than two decades.
- **Corporates:** Corporate fundamental trends during the fourth quarter of 2016 show that revenue and EBITDA are improving after nearly two years of negative growth. That said, debt is still increasing as companies see little incentive to switch to other forms of financing. However, they are listening to bond investors’ pleas—cash to shareholders, one reason for taking out debt, has been declining rapidly for a few quarters now.
- **Securitized Products:** Since 2013, the U.S. GSEs (Fannie and Freddie) have been selling the credit risk on mortgages that they guarantee for in the \$5.7 trillion agency mortgage market. The bonds, referred to as Credit Risk Transfer (CRT) bonds, carry the default risk of the individual loans the GSEs guarantee. The ability to trade large size in CRT had been a concern until Tuesday when \$1.3 billion easily changed hands. That is a good day FNMA.
- **High Yield:** Moody’s reported a twelve-month global default rate of 4.2% this week relative to 4.7% last month, the largest month-over-month drop since April 2014. The market has been feeling a bit of déjà vu this week as lower oil prices are softening the high yield market. However, concerns about a repeat of last year’s commodity price-driven turmoil are lower given the higher quality nature of today’s energy universe.
- **Emerging Markets:** In its fourth quarter 2016 GDP release, Brazil reported a contraction of 0.9% quarter-over-quarter and 2.5% year-over-year, weaker than consensus expectations. The release left Brazil’s 2016 full-year growth at -3.6%, similar to the -3.8% figure in 2015. The ongoing repercussions of the country’s corruption scandal have taken a significant toll on consumption and investment, though Brazil is expected to emerge from recession in 2017.
- **Currencies:** The British pound came under pressure during the past week against EUR and USD declining nearly 1% versus the USD amid evidence that the UK’s decision to leave the European Union is starting to hit economic data. UK data continued to indicate to a worsening economic picture with Friday’s reports showed manufacturing, industrial and construction output all disappointed in January. A second Scottish independence referendum is now almost inevitable, which adds to Brexit uncertainty and undermines the currency.
- **Municipals:** New issue supply almost doubled this week with over \$11 billion of issuance coming to market, led by the State of California, signaling an end to the “January effect”—a seasonal period of tight supply and strong demand—which lasted well into February this year.