

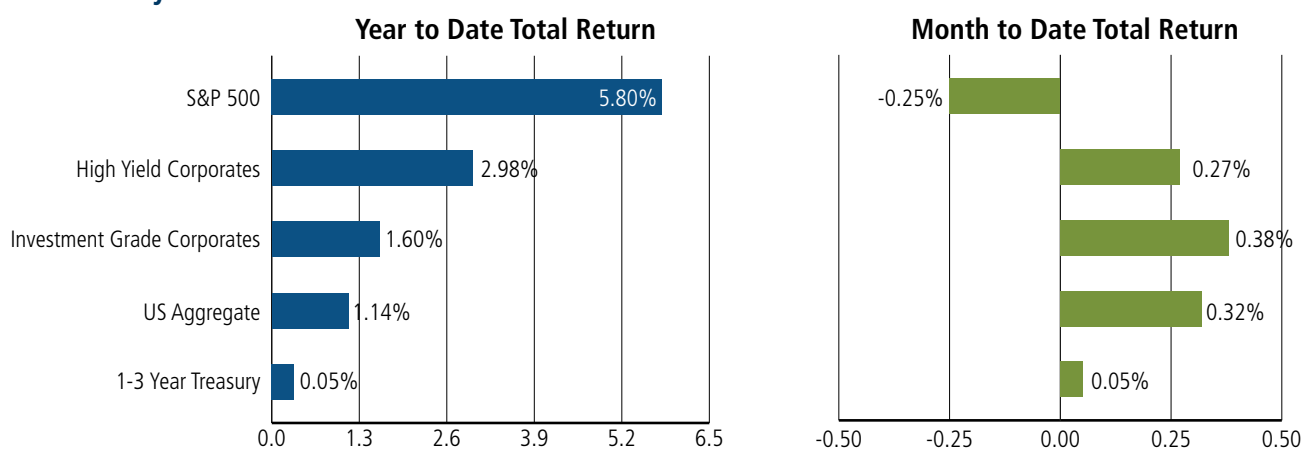
Week Ending April 7, 2017

Europe Working Through Its Problems

Economic Overview:

Headlines rage on about the political risks ahead for the euro area. Who will take France? Can we count Merkel in for 2018 and beyond? While everyone focuses on the impossible to predict, what we can say for sure is that this week, the unemployment rate in the euro area hit 9.5%, its lowest level since 2009. Improvement has been broad based—the average euro area member country witnessed a 3 percentage point decrease in its unemployment rate since peak unemployment in April 2013. Leading the charge are the Iberians and the Irish. The Spanish unemployment rate has fallen from 26.3% to 18%, the Irish unemployment rate has fallen from 13.8% to 6.6%, and the Portuguese unemployment rate has dropped from 17.1% to 10%. Whether or not politicians sort themselves out, we think the underlying economic health of the Continent will continue to improve throughout 2017.

Total Returns by Asset Class



Highlights of the Week:

- **Treasuries:** Treasuries rallied to the bottom of the range this week where they managed to hold support around 1.80% in 5's and 2.30% in 10's. Position short covering in the belly of the curve over the past several weeks seems to have exhausted the bullish camp even with a FTQ bid and a light nonfarm payroll headline number. Odds for a rate hike in May remain low at 22%, while June moved up to 60% and Sep is almost at 80%. Market is pricing in 1.7 more hikes in 2017 and a 70% chance for 2 hikes in 2018.
- **Equities:** The U.S. Equity Market fell modestly for the week as a slew of macro factors and growing pessimism of President Trump's fiscal expansionary policies weighed on market sentiment. The generally risk-off tone drove bond yields lower, helping the more interest-rate sensitive areas of the equity markets such as REITs and utilities outperform the broad market.
- **Corporates:** Unilever this week joined rank with other packaged food brands seeking to shed some of their products. The company wants to sell their margarine line as French's looks to sell their well-known yellow mustard and Danone does the same for their Stonyfield brand. Although each company has their reasons, it nonetheless makes for a crowded space (Unilever wants to fend off unwanted takeovers; Danone wants to complete its WhiteWave acquisition).
- **Securitized Products:** More trouble for shopping malls and brick-and-mortar retail as Payless Shoes declared bankruptcy and Ralph Lauren and Rue 21 announce store closures. This follows a string of negative headlines (store closures) from the top three anchor retailers – JC Penny, Macy's, and Sears. In CMBS, although cash bond spreads have been relative stable on limited supply, investors have been buying protection (from losses) on the lowest rated classes of shopping mall heavy deals via the CMBX. The basis between cash BBB bonds and the CMBX BBB basket has widened 200 basis points over the past three months.
- **High Yield:** Leverage among high yield issuers decreased in 2016 due in part to improving profitability within the energy sector. Improving leverage metrics and a manageable maturity schedule (only 13% of the market matures before 2020) are signs that the financial health of the high yield asset class remains robust.
- **Emerging Markets:** South Africa faced rating consequences from last week's cabinet reshuffle by President Zuma. S&P downgraded the country's rating to BB+/negative from BBB-/negative, dropping the rating below investment grade. Fitch made a similar move later in the week, moving South Africa to high yield at BB+/stable from BBB-/negative. Moody's placed its Baa2 rating on negative watch, and said it would wait 30-90 days to assess the impact.
- **Currencies:** Mixed economic data in the UK resulted in a volatile week for the sterling. The pound initially rose on Wednesday after the latest service sector report indicated better than expected growth. However, falling industrial output and slowing house prices growth numbers released on Friday weighed on the currency. The sterling finished the week 1.25% lower versus the dollar – its first fall in four weeks.
- **Municipals:** Municipal bond funds have recorded inflows for 9 of the 13 weeks this year. Municipal yields continue to fall and the muni yield curve has narrowed, as cash entering the market chases limited new issue supply.