Week Ending **May 12, 2017**

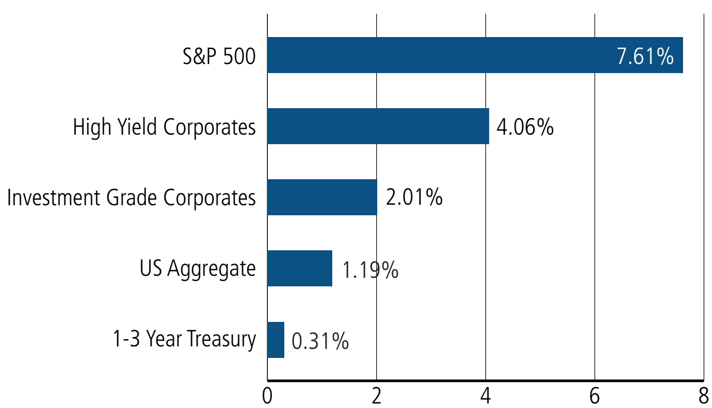
It's Quiet, Too Quiet

Economic Overview:

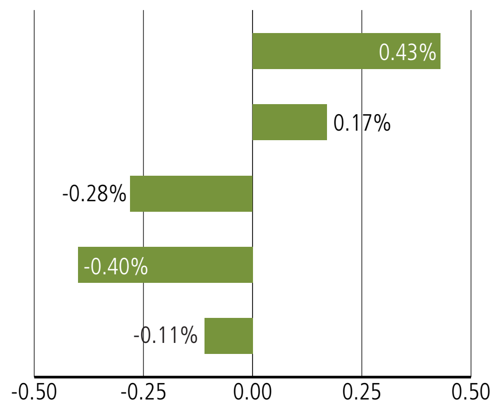
Everyone is talking about low volatility. The VIX, a measure of implied equity volatility, dropped to 9.76 this week—one of the lowest readings on record. A VIX reading below 10 is quite rare, occurring only eleven times in the 6,891 trading days since 1990. However, before you worry we are in the calm before the storm, keep in mind that while readings below 10 are rare, VIX levels in the 10-20 range are not. In fact, more than 60% of the time the index fell within the 10-20 range. Moreover, the 90-day average of the VIX hovered below 20 during the 1990s for 74 months! Quiet today does not always mean chaos tomorrow.

Total Returns by Asset Class

Year to Date Total Return



Month to Date Total Return



Highlights of the Week:

- **Treasuries:** The Treasury held their refunding auctions this past week. The auctions offer the markets a window to see what large macro Treasury investors think of current interest rates. The conclusion, less than scintillating. The Treasury auctioned $62 billion across three, ten and 30-year maturities. All three auctions "tailed," meaning the highest yield bidders received at the auction vs. where they traded just before the auction and their coverage ratios, a measure of demand, were all less than average.
- **Corporates:** The security of Canada's economy has come into question as investors have started to focus on the apparent housing bubble. This week Moody's downgraded six large Canadian banks, concerned that fundamental weaknesses could overcome supportive balance sheets and decent liquidity metrics. One fundamental data point, for example, is household debt, clocking in at 167% of disposable income, a record high.
- **Equities:** The U.S. equity market fell for the first time in four weeks on weak earnings results from major retailers and increased uncertainty surrounding the Trump administration. Despite the weekly loss, the broad market remains near record highs with investors showing an extreme level of complacency. In fact, the VIX index, also known as the "fear index," fell to the lowest intra-day level since the pre-financial crisis.
- **Emerging Markets:** China released external and monetary indicators for April. Trade momentum eased, with exports showing growth of 8.% year-over-year, down from 16.4%, while imports rose 11.9% year-over-year (down from 20.3%). The result was a larger-than-expected trade surplus for the month, and foreign reserves were also higher at $3.029 trillion. Monetary data showed a modest increase in CPI inflation at 1.2% year-over-year (from 0.9%), although PPI inflation eased to 6.4% year-over-year (from 7.6%).
- **Securitized Products:** Hungry? Church's Chicken and Five Guys are bringing their whole business securitizations (WBS) next week led by Barclays and Guggenheim, respectively. WBS falls under the "esoteric" segment of the ABS market and is a popular way for BB-rated fast food and casual dining companies to achieve BBB ratings through a bit of ABS structuring. Maturities tend to be in the five-year area, so WBS tend to be compared to CMBS. Others who have used WBS include Taco Bell, IHOP, Sonic, Dominos, Applebees, and more. Hungry now?
- **High Yield:** Volatility in risk markets is subdued. As the VIX closes in on all-time lows, the BB/B high yield bond index has not deviated by more than 25 basis points since March 30th. A combination of positive macroeconomic data and strong earnings reports has muted risk asset prices.
- **Currencies:** The New Zealand dollar came under pressure on Thursday after the Reserve Bank of New Zealand kept interest rates unchanged on the back of global economic growth concerns. The latest house sales report put additional pressure on the currency on Friday as it indicated a 31% year-over-year drop in sales. Year-to-date, the kiwi dollar is the second-worst performing major currency as the less optimistic domestic economic outlook seems to have outweighed the recent bounce in commodity prices.
- **Municipals:** Municipal bond funds have benefited from five consecutive weeks of inflows. Technical factors remain supportive of the market, as additional cash chases a supply shortage. With seasonal factors such as large coupon payments and redemptions in May, there is a projected net supply deficit of $6.4 billion. The technical factors have pushed ratios of municipal yields to Treasuries in two, five, and 10-year maturities all to fresh year-to-date lows. Thirty-year maturities are only two ratios from year-to-date lows as well.