

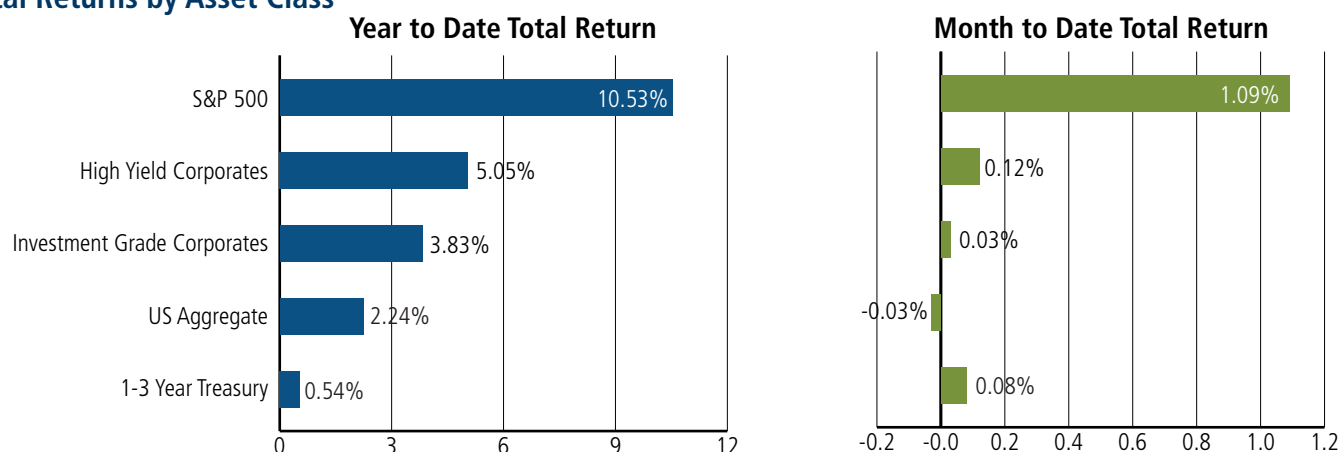
Week Ending July 14, 2017

## Joining the Party or Jumping the Gun?

## Economic Overview:

[This week, the Bank of Canada raised its overnight rate target for the first time since 2010.](#) The Canadian central bank followed in the American central bank's recent footsteps, choosing to look through low inflation readings (core CPI is up only 0.90% year-over-year as of June in Canada). The Bank of Canada said, "Canada's economy has been robust" and cited the fact that "a significant amount of slack has been absorbed" as a reason to raise the monetary policy target rate. The Canadian situation looks similar to that of the US: above-trend economic growth and evaporating "slack" means central bankers expect inflation to edge higher. Some bond traders think both banks are jumping the gun. Time will tell.

## Total Returns by Asset Class



## Highlights of the Week:

- **Treasuries:** Yellen's two-day testimony on Capitol Hill, CPI, and retail sales were the challenges this week. Altogether, the results were more "dovish" for Treasuries, sending yields lower by 6-8 basis points (bps) across the curve. Concerns about next Thursday's ECB meeting and as well as news that ECB chief Mario Draghi will appear at Jackson Hole in August—possibly setting up for a taper later in the year—sent yields up a bit at the end of the week. The 5/30's yield curve bear steepened with Fed hike probabilities lower and long end supply. Market expectations for the number of rate hikes in 2018 fell to 1.1.
- **Corporates:** The corporate IG OAS continues to grind tighter ending the week at +105 basis points, the tightest level since September 9, 2014. Second quarter earnings kicked off this week with domestic banks taking center stage as JPM, Citi, Wells all beat estimates. Corporates are in earnings "blackout," so expect the wildcard to be domestic bank issuance, as Yankee issuance dominated this past week.
- **Equities:** The U.S. equity market rallied in a relatively quiet week of trading. Investor sentiment was given a boost after the Fed signaled a slower path to higher rates. For the week, Tech was the best performing sector, while Financials were the worst performing sector despite strong quarterly earnings from U.S. bellwethers.
- **Emerging Markets:** In Brazil, the lead judge in the country's Lava Jato corruption investigation found former President Lula da Silva guilty of corruption charges and sentenced him to almost ten years in jail. Markets reacted positively to the news, as investors perceived the conviction might prohibit Lula from running in Brazil's 2018 presidential election.
- **Securitized Products:** The number of underwater borrowers fell to 1.8 million, marking the first time the figure has fallen below 2 million since 2006, according to data from Black Knight Financial Services. On a percentage basis, underwater borrowers fell 16% quarter-over-quarter and an even more impressive 35% year-over-year. The total U.S. loan delinquency rate fell to 3.79%, further demonstrating the strength of the U.S. mortgage market.
- **Currencies:** It may not have been a surprise to many when the Bank of Canada raised interest rates on Wednesday since the central bank had previously signaled its intentions. What caught many investors off guard though were the positive economic projections in the statement, as well as the confidence level of policy makers that these would be achieved as they shrugged off below target inflation. The Canadian dollar responded predictably and rose by 1.2% against the greenback on the week, while Canadian government bonds sold off across the board.
- **Municipals:** Muni fund flows have ebbed and flowed over the past month, seemingly trading inflows for outflows every other week. However, aggregate flows have been negative, with outflows of nearly \$1.2 billion over the previous four weeks. The outflows contrast with strong demand in the market, as maturities, redemptions and coupon payments outpace new issue supply and have translated to positive performance thus far for the month of July.
- **High Yield:** Despite -\$12.3 billion of fund outflows in 2017, high yield bonds have posted strong returns so far this year. As issuer fundamentals continue to improve, and as the supply of new bonds lags the rate that cash is returned to investors via calls, maturities, and coupon payments, we think an allocation to high yield will continue to be a productive component of a diversified portfolio.