

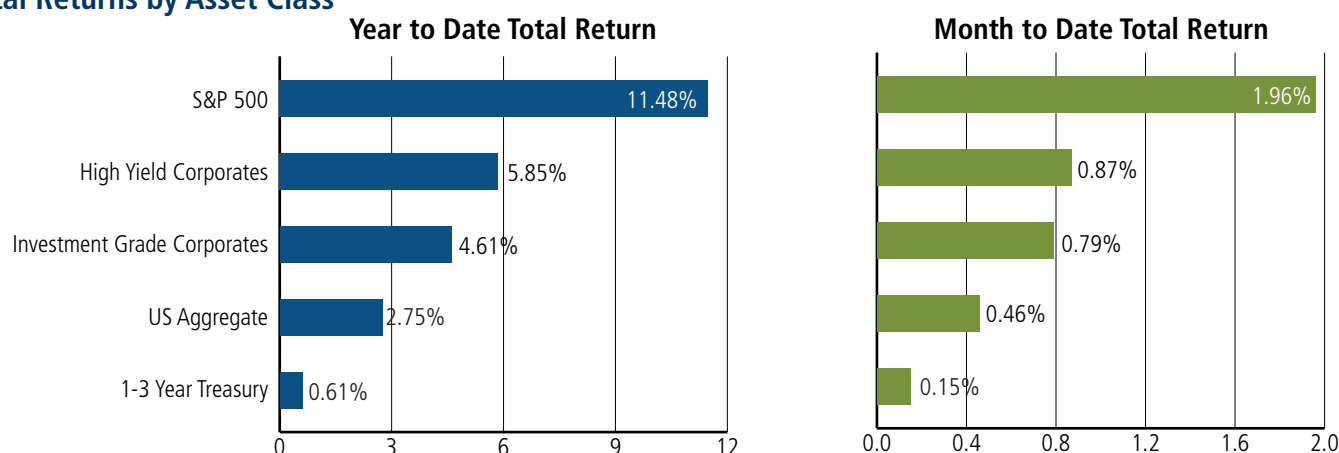
Week Ending July 21, 2017

Now You ECB Me, Now You Don't

Economic Overview:

Predictions of "euro parity" were all the rage to start 2017. A headline from the Financial Times in December 2016 read, "Economists expect euro to fall to dollar parity in 2017." Thursday, the EURUSD exchange rate jumped to \$1.16—a far cry from "parity" and the strongest reading for the euro versus the dollar in two years. The euro surge came after Mario Draghi gave the euro area the economic "thumbs up" at the European Central Bank's (ECB) July meeting, saying that "incoming information confirms a continued strengthening of the economic expansion in the euro area, which has been broadening across sectors and regions." [It seems that the ebb and flow of the ECB's balance sheet also corresponds with the rise and fall of the euro.](#) If the ECB does curtail its asset purchases based on better economic prospects, will the euro prosper?

Total Returns by Asset Class



Highlights of the Week:

- **Treasuries:** A flight to quality bid ensued in Treasuries with ECB repeating their mantra from Sintra, but disregarding EUR currency strength, creating possible greater disinflationary pressures. Yields ground to lows for the month, and the curves (2/10's and 5/30's) flattened eight basis points (bps) and five bps respectively. Volumes were "summer light" with second-tier econ data and Fed on "blackout" until next Wednesday's FOMC meeting. Hike probabilities continue to leak lower with a 50% chance for one hike in 2017 and one hike for 2018.
- **Corporates:** The corporate IG OAS continues to grind tighter ending at +104 basis points, the tightest level since September 08, 2014. U.S. Large Cap Banks were the focus of the week, with better than expected earnings reported across the board. \$31 billion of supply from each of the five big U.S. banks have been easily digested with spreads holding up well. Expect non-financial supply to pick up post the earnings "blackout" period.
- **Equities:** The U.S. Equity Market posted gains for the week after strong corporate quarterly earnings drove major stock indices to new all-time highs. Utilities and Health Care were the best performing sectors, which were largely driven by falling interest rates and the continued positive risk sentiment in growth and momentum stocks, respectively.
- **Emerging Markets:** Chinese economic activity data outperformed analyst estimates. Second quarter GDP growth came at 6.9% year-over-year (y/y), better than the 6.8% consensus forecast. Fixed asset investment (8.6% y/y), industrial production (7.6% y/y) and retail sales (11.0% y/y) were also stronger than expected.
- **Securitized Products:** Winter is here in subprime auto. Truth be told, it is always winter for subprime borrowers and lenders. We did a site tour of the Westlake Financial Services facilities this week. Site tours can yield valuable insights from front line warriors. Did you know there are at least 28 websites to get fake pay stubs? We did six site tours last year and conducted regular meetings with management because winter is here.
- **Currencies:** Reassuring comments by Britain's Prime Minister May to business leaders at the first business council meeting this week failed to impress the markets. Despite signs that some of the hard-Brexit supporters might be shifting to a less extreme stance, allowing for the possibility of a transition deal, there was little support for the British pound, which was the worst performing major currency this week. It appears as though investors might need further clarity on Mrs. May's exit strategy before they could reassess the risks to the UK economy.
- **Municipals:** The municipal yield curve has narrowed to its flattest level in nine months. Spreads between benchmark MMD 2-year and 30-year rates narrowed to 174 bps, the flattest differential since October 2016. This contrasts sharply with the widest levels of 2017, which reached 220 bps in early March.
- **High Yield:** The number of leveraged credit issuers issuing leveraged loans in addition to, or even in lieu of, cash bonds, has accelerated in recent years. As the institutional market for leveraged loans matures, sub-investment grade issuers are in a better position to optimize their capital structures, which should keep defaults at bay.