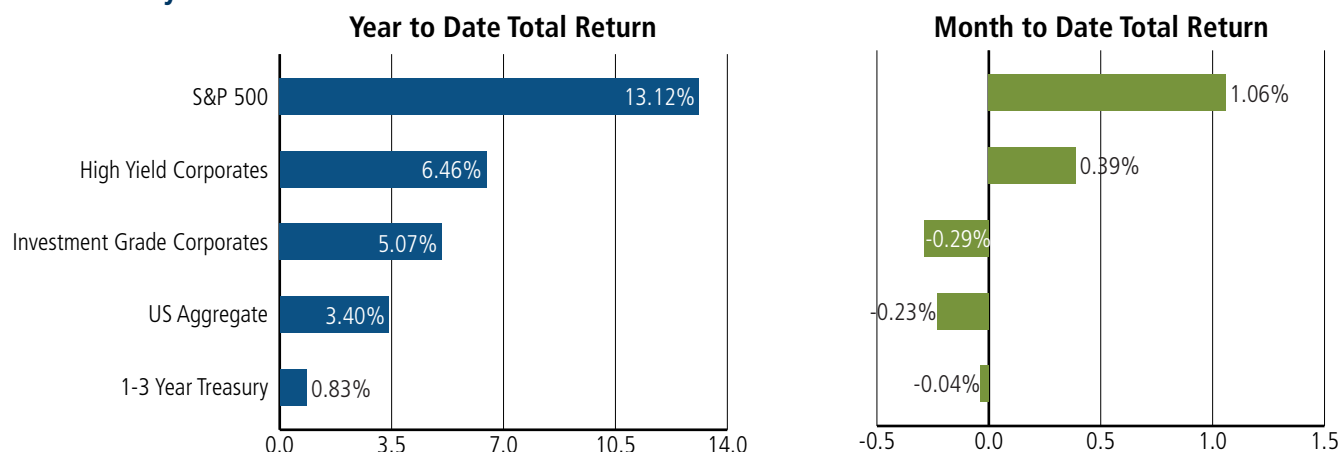


Week Ending September 15, 2017

Delayed—But Not Indefinitely**Economic Overview:**

The bond market believes lackluster inflation and wage data will restrain central banks for the rest of 2017. We are not so certain. After news that the U.K.'s unemployment rate dropped to 4.3% in the three month's ending July—its lowest level in more than 40 years—the BoE's Monetary Policy Committee (MPC) did vote to keep its policy rate on hold at 0.25%. But, in their August Inflation Report, policymakers said that while "regular pay growth remains modest in the near term [it should pick] up over the forecast period." [Indeed, average weekly earnings remain well below their pre-crisis range even as the unemployment rate is below its pre-crisis range.](#) Could it be that a pick-up in wages has been delayed, but not permanently? At least 2 of 9 MPC members agree, as they "considered it appropriate to increase Bank Rate by 25 basis points" at the September meeting. Will the bond market begin to take notice?

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

- **Treasuries:** Treasuries breathed a sigh of relief after Irma's devastation was not as bad as feared. Geopolitical tensions also cooled over the weekend. As a result, Treasury yields backed up 10-12 basis points in the belly of the curve. Also, with auctions tailing, core CPI rounding higher to stay unchanged at 1.7% year-over-year, and a more hawkish Bank of England, higher yields make sense. However, weaker retail sales on Friday and a missile launch on Thursday evening seemed to cap the selloff around the 2.20% level in the 10-year. Talk of a possible DACA deal and tax plan announcement at the end of September pushed December rate hike probabilities back up to 50% from 30% the week prior.
- **Corporates:** The market's attention has been on the new issue market as we've seen over \$37 billion issued this week, eclipsing \$80 billion for the month. The bulk of issuance is pricing flat to secondary but most are performing on the break unlike last week. Secondary trading has also been on fire on the back of higher rates and client buying, especially overseas. Risk-on has been the theme for all the aforementioned reasons along with riding the coattail of the equity market.
- **Emerging Markets:** GDP growth in Turkey was healthy at 5.1% year-over-year in the second quarter; working-day adjusted growth was even stronger at 6.5% year-over-year. While private consumption and net exports both contributed positively to output during the quarter, fixed investment was a key driver due to the robust performance of the construction sector. Acknowledging the positive growth result, the Central Bank of Turkey opted to keep its multiple policy rates unchanged, including keeping the benchmark rate at 8%.
- **Securitized Products:** The impact of the one-two punch of Hurricane Harvey & Irma remains fluid as commercial real estate property borrowers and insurance companies assess damage. There is a total of \$23 Billion in CMBS exposure to FEMA disaster zones in Houston and Florida. CMBS requires insurance but coverage (flood, wind, all-risk) is not boiler plate and policies depend on property specific factors. Credit Risk Transfer (CRT) losses are now estimated at a few basis points.
- **Currencies:** Pound sterling touched its highest level against the U.S. dollar in a year this week as the hawkish comments by the Bank of England (BoE) provided the catalyst for a strong move higher in the currency. The BoE held rates at 0.25% as expected but there was no movement in the number of dissenters as the voting split on its key policy-setting committee held steady at 7-2. Meantime, higher than expected inflation data and falling unemployment gave hawks more room to advocate a rate rise.
- **Municipal:** Renewed focus on tax reform has brought the issue back to the forefront for municipal bond investors. However, significant headwinds remain for passing comprehensive tax reform and cuts, especially if the package is to remain revenue neutral. Consensus is that the municipal tax-exemption will remain in place, and the biggest risk to the market is the passing of a sub-20% corporate tax rate.
- **High Yield:** High yield markets digested another sign of trouble in the retail sector this week. Reports that vendors are cutting shipments to Toys "R" Us due to bankruptcy fears show that concerns about the future of highly levered brick-and-mortar retailers are well-founded. Nonetheless, investors should not write off the retail sector completely. Restaurants that offer experiences rather than goods, for example, are far less vulnerable to "Amazonification" than specialty retailers.