

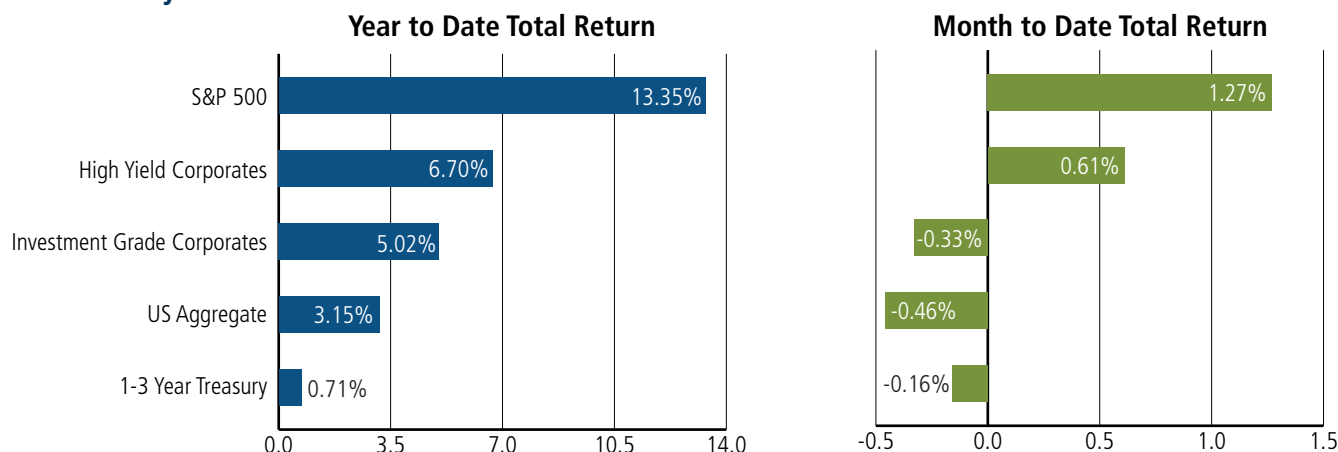
Week Ending September 22, 2017

Guess Who's Back?

Economic Overview:

At the start of the year, investors worried a lot about euro area growth due to the uncertainty of elections and potential Brexit fallout. We advised investors to ignore politics and focus on underlying fundamentals. Indeed, the euro area unemployment rate fell to 9.1% in July, its lowest level since the start of 2009. [Economic growth on the continent rose 2.3% year-over-year in Q2 2017, its fastest annual growth pace since Q1 2011](#). Measures of manufacturing, business sentiment and consumer confidence all point to a continued pick-up in growth in 2017 and beyond. Well, forecasters appear to be taking notice at long last. After slashing forecasts post-"Brexit," forecasters have continually upgraded their GDP expectations as 2017 progresses. In sharp contrast to prior years when the euro area seemed to always find a way to disappoint, 2017's progress means Europe is back.

Total Returns by Asset Class



Highlights of the Week:

- **Treasuries:** The much anticipated September FOMC meeting came and went with the well-advertised balance sheet unwind announced to start in October and three more rate hikes reiterated in 2018. The market digested the more hawkish stance with yields backing up another eight basis points in the belly of the curve. The probability for a rate hike in December moved higher, and curves bear flattened back to levels not seen since 2007. Economic data, fed speakers and treasury supply comes back in force next week.
- **Corporates:** With over \$94 billion of issuance so far in September, this week offered the market somewhat of a breather with only \$14 billion hitting the tape. With the primary market taking a break, the secondary market caught a bid with everyone looking to put money to work. The Corporate OAS is now at 106, four basis points from YTD tightens but still 17 basis points tighter on the year. Risk-on continued to be the theme as buyers have outnumbered sellers which put pressure on dealer inventories.
- **Emerging Markets:** Bank Indonesia opted to cut its policy rate for a second consecutive month, moving to 4.25% from 4.5%, acting against consensus that it would remain on hold. Officials have been on a prolonged easing cycle since the beginning of 2016, as they see inflation moving sustainably lower and credit growth as relatively weak.
- **Mortgages:** The Federal Reserve met market expectations by announcing that balance sheet reduction will begin in October. The Fed will move slowly in the normalization process with an initial \$10 billion in runoff (\$6 billion in Treasuries and \$4 billion in mortgage-backed securities) with incremental increases over the coming quarters. Since this was well choreographed, the impact on the agency mortgage market has been muted and spreads actually tightened (on the week) as rates hovered in a narrow band.
- **Currencies:** The New Zealand dollar remained volatile this week with only a few days to go until the general election in the country on Saturday. The latest polls indicated that support for opposition leader Jacinda Ardern, which had surged since her appointment as Labour leader in early August, was shifting back in favor of the incumbent National Party. The prospect of the National Party ruling alone without a coalition supported the New Zealand dollar, which outperformed all other G-10 currencies this week.
- **High Yield:** Performance in all but three of the sixty-four subsectors in the Merrill Lynch high yield universe has been positive during the third quarter. Notably, the three subsectors that did post negative returns face secular headwinds. When it seems like the only direction markets move is up, it's crucial to remember that fundamentals still matter.
- **Equities:** The U.S. Equity Market ended the week unchanged as increased geopolitical tension weighed on investor sentiment. The worst performing sectors were Real Estate and Utilities, which was a direct result of the hawkish Fed. Telecom bucked the trend after ending the week as the best performing sector as news swirled of a potential M&A deal between T-Mobile and Sprint. Financials was another strong performer as the prospect of corporate profits rose with the rise in interest rates.