

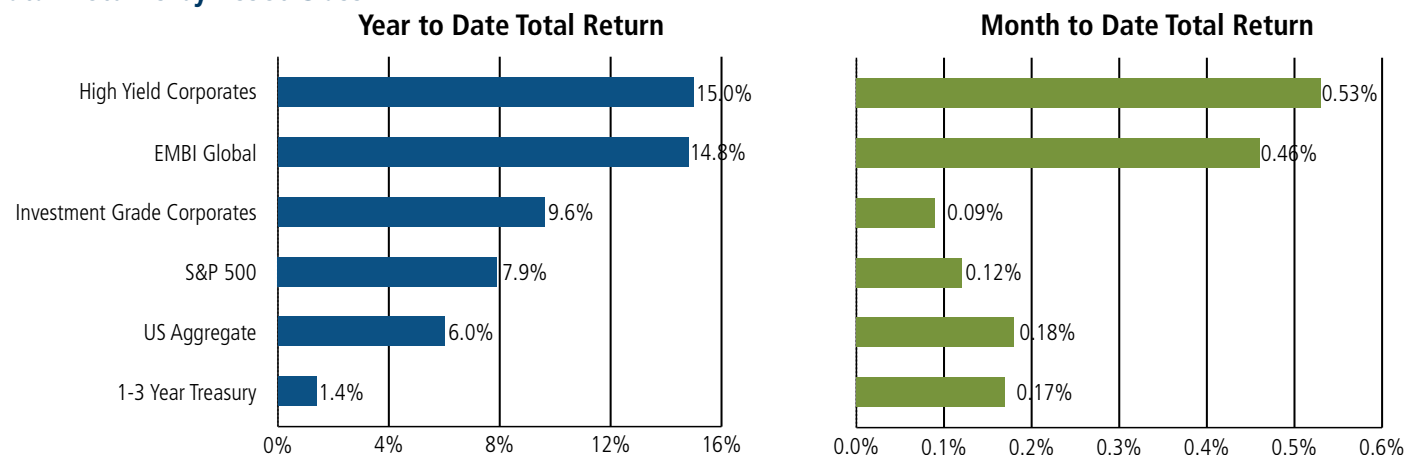
Week Ending September 30, 2016

## Oil Cartel Rears Its Head and Roils Market

### Economic Overview:

The Fed keeps talking about inflation below its target. Many investors tell us “there is no inflation.” And for much of 2015, inflation was low. But the Fed’s preferred inflation gauge, the core PCE price index, which excludes food and energy prices, is now back at 1.7% year-over-year—not particularly unusual, considering that on average over the last two decades, core PCE has been 0.3% below 2%. Will the pick up in inflation persist? We think so, and expect core PCE to continue to converge toward 2%. At a minimum, confidence that inflation is certainly depressed seems misplaced. Are investors also too complacent about interest rates staying low? After all, with the unemployment rate very near one of the Fed’s dual mandate objectives (4.9% versus 4.8%) and inflation nearing the other part at 2%, shouldn’t the Fed be closer to a neutral policy stance?

### Total Returns by Asset Class



### Highlights of the Week:

- **Treasuries:** Treasury markets absorbed the 2/5/7 year auctions without much fanfare with small tails and slightly weaker indirect participation across the board. The Deutsche Bank credit quality concerns were the catalyst for yields to grind lower with the 10-year testing the 1.55% level and holding.
- **Equities:** The U.S. Department of Justice (DOJ) fined Deutsche Bank, one of Europe’s largest banks, \$14 billion for its role in the U.S. housing crisis, sending bank stocks and broad equity markets in a tailspin. On Friday, Deutsche Bank was reported to have settled with the DOJ on a fine of only \$5.4 billion, which helped stocks recover most of the week’s losses.
- **Corporates:** Deutsche Bank had a volatile week, first after Chancellor Merkel said Germany would not support a bailout, and second when Deutsche Bank’s CEO rushed to shore up confidence in the bank’s ability to withstand client withdrawals and third after reports came out that the lender is nearing a \$5.4 billion settlement.
- **Structured Product:** Primary mortgage rates are back to lows of the year at 3.42% for 30-year conventional loans according to Freddie Mac. Zopa, the U.K.’s largest peer-to-peer (P2P) lending platform for online unsecured consumer loans, is bringing Europe’s first ABS securitization of its type. Deutsche Bank is arranging the deal to be called Marketplace Originated Consumer Assets 2016-1, or MOCA 2016-1 for short.
- **High Yield:** OPEC drove crude prices to the high 40s by announcing a production cut for later this year. Whether the oil rally is sustainable remains to be seen, but high yield shale producers in the U.S. could benefit from OPEC production discipline.
- **Emerging Markets:** Mexico’s central bank (Banxico) hiked the overnight rate by 50 basis points to 4.75% and included, “nervousness arising from the possible consequences of the electoral process in the United States” in its policy statement. Banxico is concerned that Mexican peso weakness may filter through to higher inflation expectations, and has worked to stay ahead of the curve.
- **Municipals:** The SIFMA weekly floating rate index moved higher again this week to 0.84%, the highest level since 2008. In other news, California’s Treasurer John Chiang issued a 12-month sanction against Wells Fargo including a ban on underwriting certain California municipal bonds. Wells Fargo was the second-largest underwriter of California municipal debt in the first half of 2016.
- **Currencies:** Investors have been following the link between the US Presidential election campaign and the Mexican peso closely over the last few months. As the peso soared by more than 2% against the US dollar following Clinton’s perceived victory at Monday’s debate, there seems to be little doubt left about the strength of the correlation.