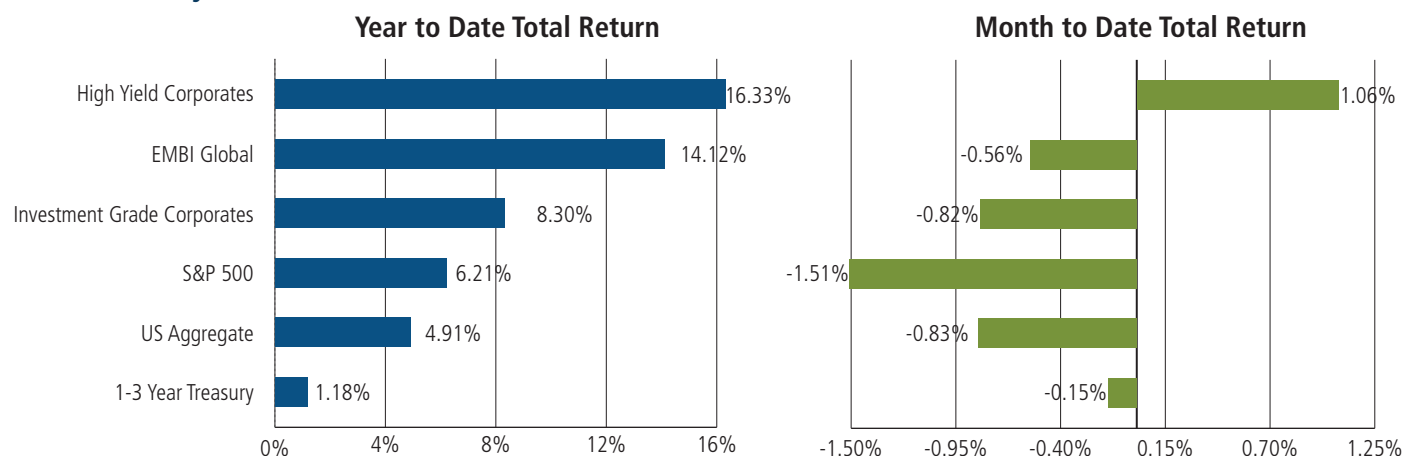


Week Ending October 28, 2016

Good Economic News Out of Britain Rattles Rates**Economic Overview:**

Conventional wisdom said that a vote to leave the European Union in June would immediately plunge the United Kingdom into recession. The first read of third quarter economic output suggests otherwise. The UK grew 0.5% quarter-over-quarter in Q3, led by strong growth in services. The positive performance follows quarterly growth of 0.4% and 0.7% in Q1 and Q2, respectively. It's still possible investment and hiring will suffer in the quarters ahead as Brexit unfolds. But investors appear to have been bracing for worse, sooner. Our evidence? After the better-than-expected GDP news, UK government bond yields moved sharply higher. Yields on government bonds in Europe and the US followed the UK's lead and also moved higher on the week.

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

- **Treasuries:** US Treasury yields backed up 10-12 basis points on the long end. German bunds (+16 bps) and UK gilts (+17 bps) also rose. Higher yields are predicated on talk of less monetary accommodation by central banks, stronger fiscal stimulus, higher breakevens (inflation concerns) and large corporate supply globally. The market now places a 75% chance of a December Fed rate hike.
- **Equities:** Equity markets were mixed this week with corporate earnings season and M&A dominating headlines. The largest deal announced was AT&T agreeing to acquire media company Time Warner Inc. for \$85 billion in cash and stock. AT&T looks to add Time Warner's content, which includes HBO and Warner Bros, to their massive distribution platform.
- **Corporates:** A recent stringent crackdown by anti-trust regulators has halted several mergers and acquisitions from being completed in the last year. Despite this slowdown, companies seeking to merge have still been rolling merrily ahead with their intentions. In fact, October 2016 now ranks as the month with the most corporate merger agreements ever, nearly breaking \$250 billion. Whether or not they will be completed is another story.
- **Securitized Product:** There is growing concern that the US Department of Housing and Urban Development will announce another mortgage insurance premium (MIP) cut on Federal Housing Administration loans. The impact would be an acceleration of prepayments for slightly seasoned Ginnie Mae mortgages. While mortgage refinance is commonplace, Lending Club announced this week an auto loan refinance program in California for borrowers with a minimum 640 FICO.
- **High Yield:** Despite retail flows stalling in the last three weeks, the market remains well bid. A combination of foreign capital flows and separately-managed accounts are providing price support as the market grinds tighter. Coupling this tailwind with prudent credit selection will reward long-term investors.
- **Emerging Markets:** EM currencies were between flat and 1% weaker this week vs. the US dollar, with the notable exception of Chilean peso; copper prices jumped more than 4.5%, underpinning the 2.6% rally in the currency. China's Q3 GDP growth print was 6.7%, in line with forecasts and reinforcing the government's strong dedication to achieving expectations and market stability. EM USD-denominated bond spreads were flat at 333 bps.
- **Municipals:** While municipal yields have drifted near 7-month highs, the market has showed resilience in the face of over \$16 billion in new supply over the past two weeks. After the first week of fund outflows YTD last week, investors added \$335 million to funds this week. Municipals remain very attractive on a relative basis with 30-year municipals yielding in excess of 100% of Treasuries.
- **Currencies:** The Swedish Krona hit the headlines this week after the Riksbank sent dovish signals to investors on Thursday. Despite keeping the benchmark repo rate unchanged at -0.5%, the Riksbank's commitment to potentially extending its bond purchasing programme pushed the Swedish currency to a 6-year low against the euro. The "lower for longer" interest rate outlook and the increased probability of further easing meant that the Swedish Krona was the worst performing G10 currency this week.

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